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Volume 52 | Number 4

Article 4

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3-1-1974

# Hospital Regulation after Aston Park: Substantive Due Process in North Carolina

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# Hospital Regulation After Aston Park: Substantive Due Process in North Carolina

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## I. INTRODUCTION

In 1971 the North Carolina General Assembly enacted two “related” bills as a response to the “impending tightening up of federal Hill-Burton moneys for construction of health facilities.”<sup>1</sup> One provided revenue-bond financing for construction of hospitals owned by private, nonprofit agencies;<sup>2</sup> the other required builders to obtain a “certificate of need” from the North Carolina Medical Care Commission before any new construction increasing hospital bed capacity would be allowed.<sup>3</sup> In 1973 the North Carolina Supreme Court de-

1. Warren, *Legislative Summary of the 1971 General Assembly—Counties*, POPULAR GOVERNMENT, Sept. 1971, at 39-40.

2. The North Carolina Medical Care Commission Hospital Facilities Finance Act, ch. 597, [1971] N.C. Sess. Laws 522 (codified at N.C. GEN. STAT. §§ 131-138 to -162 (Supp. 1973) ). A 1973 amendment substituted the name Department of Human Resources in place of the former reference to the North Carolina Medical Care Commission, ch. 476, § 152, [1973] N.C. Sess. Laws 642.

3. An Act to Provide for Orderly and Adequate Development of Health and Medical Facilities by Requiring the Issuance of a Certificate of Need, ch. 1164, [1971] N.C. Sess. Laws 1715 (repealed 1973).

clared both acts unconstitutional<sup>4</sup> and thus completely destroyed the legislative program for planning and financing private hospital construction. Both decisions were based on judicial evaluations of society's interest in hospitals, and in each case the opinion of a unanimous court was that the public interest did not warrant the measures taken by the legislature.<sup>5</sup> The issue was "public purpose" in one case and "substantive due process" in the other. Together, these decisions seem to indicate that in North Carolina the state should not intervene in the regional planning and financing of private hospital construction.<sup>6</sup>

The decision in the "public purpose" case—*Foster v. Medical Care Commission*<sup>7</sup>—should not have been entirely unexpected and will not be discussed at length here. In that case the court held that no public purpose<sup>8</sup> justified revenue-bond financing to subsidize private, nonprofit hospital construction. Although many would have disagreed by arguing that nonprofit hospitals are quasi-public<sup>9</sup> and although a number of state supreme courts have ruled to the contrary,<sup>10</sup> the decision clearly follows North Carolina precedent. Recently the North Carolina Supreme Court has demonstrated that it is less willing than other state courts to allow government financial involvement in private enterprise,<sup>11</sup> and it has never sanctioned revenue-bond financing for projects that will ultimately be privately owned unless it has been shown that private enterprise is unable to cope with the social problem that prompted the legislature to act.<sup>12</sup>

4. *Foster v. Medical Care Comm'n*, 283 N.C. 110, 195 S.E.2d 517 (1973) (invalidating the Hospital Facilities Finance Act); *In re Aston Park Hosp., Inc.*, 282 N.C. 542, 193 S.E.2d 729 (1973) (invalidating the certificate-of-need law).

5. Both opinions were written by Justice Lake.

6. *But see* text accompanying notes 190-209 *infra*.

7. 283 N.C. 110, 195 S.E.2d 517 (1973), *noted in* 52 N.C.L. REV. 859 (1974).

8. N.C. CONST. art. V, § 2(1) provides that "The power of taxation shall be exercised . . . for public purposes only . . . ."

9. *See Somers, Regulation of Hospitals*, 400 ANNALS 69, 74 (1972); *cf. Rev. Rul.* 69-545, 1969-2 CUM. BULL. 117.

10. *See* cases cited in *Foster v. Medical Care Comm'n*, 283 N.C. 110, 127, 195 S.E.2d 517, 529 (1973).

11. *See Martin v. North Carolina Housing Corp.*, 277 N.C. 29, 175 S.E.2d 665 (1970); *Mitchell v. Industrial Dev. Financing Authority*, 273 N.C. 137, 159 S.E.2d 745 (1968).

12. *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 33, 199 S.E.2d 641, 653 (1973); *Martin v. North Carolina Housing Corp.*, 277 N.C. 29, 50, 175 S.E.2d 665, 677 (1970); *Mitchell v. Industrial Dev. Financing Authority*, 273 N.C. 137, 157-58, 159 S.E.2d 745, 759 (1968); *Wells v. Housing Authority*, 213 N.C. 744, 748, 197 S.E. 693, 696 (1938); *see Note, Constitutional Law—Public Purpose—Restricting Revenue Bond Financing of Private Enterprise*, 52 N.C.L. REV. 859 (1974); *Note, Taxation and Revenue Bonds to Finance Low-Income Housing*, 49 N.C.L. REV.

Ironically, while the Medical Care Commission was arguing in *Foster* that a *shortage* of hospital beds in Raleigh made state subsidies necessary, it was arguing under the certificate-of-need law that an *overabundance* of beds in Asheville justified denying a certificate for new construction there.

Although the decision was not entirely unprecedented,<sup>13</sup> *In re Aston Park Hospital, Inc.*<sup>14</sup> was less expected than *Foster*. *Aston Park* caused "[a] SHOCK wave [to] hit the nation's hospital and comprehensive planners."<sup>15</sup> This was because "[t]he major legislative accomplishment in the health care field at the state level [was] declared unconstitutional in its first test in a state supreme court."<sup>16</sup> At

830 (1971). Although "public purpose" decisions necessarily involve the court in making policy decisions of a sort normally expected only from the legislature, *Martin v. North Carolina Housing Corp.*, *supra* at 43-45, 175 S.E.2d at 672-74; *Mitchell v. Industrial Dev. Financing Authority*, *supra* at 144-45, 159 S.E.2d at 750-51, they are distinct from the "substantive due process" decisions which will be discussed below. The North Carolina constitution necessarily requires the courts to give substantive content to "public purpose" since historically the object of the public purpose requirement was to hem in spendthrift legislatures. See McAllister, *Public Purpose in Taxation*, 18 CALIF. L. REV. 137 (1930). See also Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 277-84 (1963); Note, *Meaning of Public Purpose*, 25 N.C.L. REV. 504 (1947). To attribute substantive content to a "due process" or "law of the land" clause (N.C. CONST. art. I, § 19) however, is more a judicially created phenomenon. See Hamilton, *The Path of Due Process of Law*, ETHICS, April 1938, at 265.

13. See text accompanying note 83 *infra*.

14. 282 N.C. 542, 193 S.E.2d 729 (1973).

15. Curran, *A Severe Blow to Hospital Planning: "Certificate of Need" Declared Unconstitutional*, 288 N. ENG. J. MED. 723 (1973).

16. *Id.* See also *Certificate-of-Need Law Ruled Unconstitutional by North Carolina Supreme Court*, HOSPITALS, March 1, 1973, at 165; *Court Strikes Down North Carolina Certificate of Need Law*, MOD. HOSP., March 1973, at 50; *Correspondence*, 288 N. ENG. J. MED. 1186 (1973). A lower court in New York and a federal court in California had reviewed and upheld certificate-of-need laws prior to the *Aston Park* decision. *Attoma v. State Dep't of Social Welfare*, 26 App. Div. 2d 12, 270 N.Y.S.2d 167 (1966); *Simon v. Cameron*, 337 F. Supp. 1380 (C.D. Cal. 1970). A writer who characterized *Aston Park* as a "kneejerk free enterprise reaction" equitably dismissed the others as "kneejerk state-regulated market reactions." *Correspondence*, 288 N. ENG. J. MED. 1186, 1187 (1973).

The health-care planners were "shocked" because they have placed high hopes on certificate-of-need laws. Short of comprehensive government regulation, planners hope that "need" determinations will be a means of directing regional hospital construction to ensure efficient allocation of limited health-care manpower and material resources. The ultimate goal is to curb the rising costs of hospitalization. See Elsasser & Galinski, *Status of State Legislation*, HOSPITALS, Dec. 16, 1971, at 54; Gottlieb, *Certification of Need—Potential Threat to Planning*, HOSPITALS, Dec. 16, 1971, at 51; Ward, *Hospital Care Regulation*, HOSPITALS, April 1, 1972, at 101; *Guidelines for Implementation of Certificates of Need for Health Care Facilities and Services*, HOSPITALS, Jan. 16, 1972, at 125; TENNESSEE LEGISLATIVE COUNCIL, *STUDY ON HEALTH PLANNING AGENCIES AND "CERTIFICATE OF NEED" LEGISLATION CONCERNING HEALTH FACILITIES* (1973).

the time *Aston Park* was decided twenty-one states had enacted certificate-of-need laws.<sup>17</sup>

The lawsuit underlying the decision was brought by Aston Park Hospital, Inc. after the Medical Care Commission refused to issue it a license necessary for entry into the hospital business. The license was refused because the private, for-profit corporation had been denied a certificate of need, and the certificate had been denied because, after a hearing and investigation, the Medical Care Commission determined that the proposed Aston Park Hospital would expand the total hospital bed capacity of the Asheville area beyond the needs of the regional community. Section 90-291(e) of the North Carolina General Statutes prohibited issuance of a certificate in such circumstances on the theory that excess bed capacity resulted in needless duplication and waste of limited medical manpower and material resources.<sup>18</sup> The court held that certificates of need could not be used to prohibit private entrepreneurs from entering into the hospital business. Its holding was based on the "law of the land" or "due process" clause of the state constitution.<sup>19</sup> As corollaries to the "law of the land" holding, the court held that the constitutional proscriptions of monopolies<sup>20</sup> and exclusive privileges<sup>21</sup> were also violated.<sup>22</sup>

The decision in *Aston Park* may encourage proprietary hospitals to challenge the certificate-of-need laws in other states.<sup>23</sup> In the long run, however, the case may mean that the judiciary has decided for North Carolina what Professor Havighurst has styled the "overriding choice" in the controversy over health policy: "The issue before the public is whether health care should become the next great 'regulated industry,' indeed the first one brought by Congress under comprehensive economic regulation since the 1930's."<sup>24</sup> At any rate, the approach of *Aston Park* (with *Foster*) stands in startling contrast to the broad legislative policy enunciated by a North Carolina Legislative Research Commission in 1971:

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17. *Court Strikes Down North Carolina Certificate of Need Law*, MOD. HOSP., March 1973, at 50.

18. Ch. 1164, § 1, [1971] N.C. Sess. Laws 1716 (repealed 1973).

19. "No person shall be . . . in any manner deprived of his life, liberty or property, but by the law of the land." N.C. CONST. art. I, § 19.

20. *Id.* art. I, § 32.

21. *Id.* art. I, § 34.

22. 282 N.C. at 551, 193 S.E.2d at 736.

23. See *Correspondence*, 288 N. ENG. J. MED. 1186, 1187 (1973).

24. Havighurst, *Foreword to Health Care: Part I*, 35 LAW & CONTEMP. PROB. 229, 232 (1970). A part of the "issue" is whether Congress or the states should undertake the regulation.

All major health related groups, organizations, agencies and most knowledgeable individuals now agree that adequate health care is a basic human right, not simply a privilege. Governmental policy, then, must be based on this principle. Therefore, the following general guidelines for a state health policy are suggested

. . . .

State and local governments in North Carolina should more vigorously and positively assume their proper responsibility to assure that the health needs of the citizens are met in whatever ways are adequate and by whatever means are available to the government. This exercise of responsibility includes the full and effective utilization of resources at hand and the development of other resources necessary to meet the health needs of the people of this state in a comprehensive fashion. This means that priorities must be arranged in state and local financing and budgeting so as to give health planning and service programs the urgent attention required in these times of manpower shortage and health care demand. Government must facilitate private and voluntary activity in all facets of health care and concern; at the same time government must be ready to fill the gaps so that all portions of the population will have access to medical care and preventive services. . . . Plans, programs and people should be co-ordinated for the sake of maximum benefit to the people.<sup>25</sup>

## II. SUBSTANTIVE DUE PROCESS IN NORTH CAROLINA

### A. Background

Certificate-of-need laws absolutely deny entry into a field of economic enterprise according to a criterion (public need) that is beyond the control of any individual. A constitutional attack on restricted entry into a business forces a court to decide the extent to which it will give substantive content to the "due process" clause (or its equivalent) in the constitution which controls the question.<sup>26</sup> Inevitably this involves the court in making decisions about social and economic policy of a sort usually reserved for the legislature: essentially, the court must balance the individual freedom to make contracts and the right to engage in a business against the police power of the state. In order to reach its decision, a court must answer two

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25. 1971 REPORTS OF THE LEGISLATIVE RESEARCH COMMISSION TO THE NORTH CAROLINA GENERAL ASSEMBLY, HEALTH 14-15. This report did not specifically study or even mention either the Health Facilities Finance Act or the certificate-of-need law.

26. See *State v. Smith*, 265 N.C. 173, 180, 143 S.E.2d 293, 299 (1965), for a definition of "substantive due process" in a somewhat different context from occupational licensing.

questions. First, it must determine whether the legislation is within the range of legislative judgments that a court may upset. Secondly, if the court decides to review the legislative judgment, it must decide whether the regulation before it violates the judge-made standard for testing the merits of individual legislation. Typically, these two questions are merged in a single inquiry. Most courts state the "due process" standard for economic regulation as Justice Lake did for the court in *Aston Park*:

"If a statute is to be sustained as a legitimate exercise of the police power, it must have a rational, real, or substantial relation to the public health, morals, order, or safety, or the general welfare. In brief, it must be reasonably necessary to promote the accomplishment of a public good, or to prevent the infliction of a public harm."<sup>27</sup>

How a court applies this test determines the relative roles of the courts and the legislature in determining the social policy that guides state government.

The debate over whether the United States Supreme Court should substantively review economic legislation under the federal due process clauses is well known.<sup>28</sup> Before the watershed cases of the mid-1930's, the Supreme Court effectively prohibited most comprehensive economic regulation, so militant was it to maintain individual contractual and proprietary rights which, the Court reasoned, could only be protected by preserving free enterprise and unfettered competition in the market place. In case after case decided under the appropriate due process clause, the Supreme Court declared regulatory legislation to be beyond the police power of the legislature.<sup>29</sup> Then, within a re-

27. 282 N.C. at 551, 193 S.E.2d at 735, quoting *State v. Ballance*, 229 N.C. 764, 769, 51 S.E.2d 731, 735 (1949).

28. See generally Thayer, *The Origin and Scope of the American Doctrine of Constitutional Law*, 7 HARV. L. REV. 129 (1893); Pound, *Liberty of Contract*, 18 YALE L.J. 454 (1909); Hamilton, *The Path of Due Process of Law*, ETHICS, APRIL 1938, at 269; Rodes, *Due Process and Social Legislation in the Supreme Court—A Post Mortem*, 33 NOTRE DAME LAW. 5 (1957); Hetherington, *State Economic Regulation and Substantive Due Process of Law* (pts. 1-2), 53 NW. U. L. REV. 13, 226 (1958); McCloskey, *Economic Due Process and the Supreme Court: An Exhumation and Reburial*, 1962 SUP. CT. REV. 34; Struve, *The Less-Restrictive-Alternative Principle and Economic Due Process*, 80 HARV. L. REV. 1463 (1967); Strong, *The Economic Philosophy of Lochner: Emergence, Embrasure and Emasculation*, 15 ARIZ. L. REV. 419 (1973). See also notes 29-32 *infra*.

29. See *Lochner v. New York*, 198 U.S. 45 (1905); *Tyson & Bro. v. Banton*, 273 U.S. 418 (1927), overruled *sub silentio* in *Gold v. DiCarlo*, 380 U.S. 520 (1965) (*per curiam*); *New State Ice Co. v. Liebman*, 285 U.S. 262 (1932). These cases illustrate the former willingness of the Supreme Court to review substantively economic regulation in areas of employment relations, price fixing, and restrictions on business entry

markably short period in the 1930's, the Court reversed its position.<sup>30</sup> The legislature, and not the Court, was thereafter identified as the appropriate forum in which to decide whether the public interest warranted regulatory legislation that limited property rights.<sup>31</sup> Since then the Supreme Court has refused to decide whether economic legislation is necessary to accomplish a substantial interest as long as any state of facts can be conceived that would justify the legislative judgment.<sup>32</sup>

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respectively. Strong dissents were filed in the first two cases by Justice Holmes and in the third by Justice Brandeis.

30. With its reversal the Court abandoned its former doctrine that only free competition in the market secures individual freedom. Free competition and *laissez faire* were no longer held to be constitutionally mandated any more than other economic philosophies. Thus, depending on its appraisal of economic factors in a given industry, the legislature was free to choose any economic system to serve the public interest. As to economic philosophy the Constitution was said to be neutral. See generally Strong, *supra* note 28.

31. *Nebbia v. New York*, 291 U.S. 502 (1934); *United States v. Carolene Prods. Co.*, 304 U.S. 144 (1938); and *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955), are examples of substantive due process cases decided after the Supreme Court withdrew from close review of economic regulation.

32. Writing for a majority of the Court in 1941 Mr. Justice Douglas said:

We are not concerned with the wisdom, need, or appropriateness of the legislation. Differences of opinion on that score suggest a choice which "should be left where . . . it was left by the Constitution—to the States and to Congress." . . . There is no necessity for the state to demonstrate before us that evils persist despite the competition which attends the bargaining in this field. In final analysis, the only constitutional prohibitions or restraints which respondents have suggested for invalidation of this legislation are those notions of public policy embedded in earlier decisions of this Court but which, as Mr. Justice Holmes long admonished, should not be read into the Constitution. . . . Since they do not find expression in the Constitution, we cannot give them continuing vitality as standards by which the constitutionality of the economic and social programs of the states is to be determined.

*Olsen v. Nebraska*, 313 U.S. 236, 246-47 (1941). *Olsen* dealt with price regulation. For a similar case dealing with occupational licensing see *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955).

The quoted language fairly states the present doctrine of the Supreme Court on occupational licensing and utility regulation, both of which are forms of economic regulation. See *Brotherhood of Locomotive Firemen & Engineers v. Chicago, R.I. & P.R.R.*, 393 U.S. 129, 144 (1968); *Gold v. DiCarlo*, 380 U.S. 520 (1965) (per curiam); *Ferguson v. Skrupa*, 372 U.S. 726 (1963). Nevertheless, it is sometimes suggested that the Supreme Court has begun again to render decisions which in effect amount to substantive due process opinions. See *Boddie v. Connecticut*, 401 U.S. 371, 384-85 (1971) (Douglas, J., concurring). But see *United States v. Kras*, 409 U.S. 434 (1973), noted in 52 N.C.L. REV. 172 (1973). See also *Roe v. Wade*, 410 U.S. 113 (1973); R. POSNER, *ECONOMIC ANALYSIS OF LAW* 266-76 (1972); Friedman, *Freedom of Contract and Occupational Licensing 1890-1910: A Legal and Social Study*, 53 CALIF. L. REV. 487, 532-34 (1965); McCloskey, *supra* note 28, at 54-62; Struve, *supra* note 28. Others argue that the Court now exercises substantive review under the equal protection clause rather than utilizing the due process rubric. See Karst, *Invidious Discrimination: Justice Douglas and the Return of the "Natural-Law-Due-Process Formula"*, 16 U.C.L.A.L. REV. 716 (1969). See also Gunther, *The Supreme Court 1971 Term—Foreword: In Search of Evolving Doctrine in a Changing Court: A Model for*



### B. Substantive Due Process in State Courts

Many state courts, on the other hand, refused to follow the Supreme Court in delivering individual economic rights into the hands of the legislature.<sup>33</sup> Plaintiffs aggrieved by legislative regulation therefore ceased bringing their suits under the due process clause of the fourteenth amendment and began to claim violations of equivalent clauses in state constitutions. State court interpretations of state constitutions were, of course, final. In this area Supreme Court precedent was only "persuasive."<sup>34</sup> Since the Supreme Court no longer wrote economic due process opinions that expressed acceptable tenets to many state courts, the state courts did not hesitate to take their precedent from pre-1930's Supreme Court cases.<sup>35</sup>

Whether the state courts are justified in continuing to review the substance of economic legislation has been debated.<sup>36</sup> The argument against such review is based on the different roles that state and

*a Newer Equal Protection*, 86 HARV. L. REV. 1 (1972). *But cf.* *San Antonio Independent School Dist. v. Rodriguez*, 411 U.S. 1 (1973); *Weber v. Aetna Cas. & Sur. Co.*, 406 U.S. 164 (1972); *Dandridge v. Williams*, 397 U.S. 471, 484-85 (1970).

33. *See, e.g., Cox v. General Elec. Co.*, 211 Ga. 286, 291, 85 S.E.2d 514, 519 (1955); *Boomer v. Olsen*, 143 Neb. 579, 585-86, 10 N.W.2d 507, 511 (1943); *State v. Harris*, 216 N.C. 746, 757-58, 6 S.E.2d 854, 862 (1940); Hetherington, *supra* note 28; Paulsen, *The Persistence of Substantive Due Process in the States*, 34 MINN. L. REV. 91 (1950); Strong, *Constitutional Law, Survey of North Carolina Case Law*, 44 N.C.L. REV. 934, 946-47 (1966); Comment, *Due Process of Law and Economic Legislation—North Carolina Style*, 1 DUKE B.J. 51 (1951); Note, *Counterrevolution in State Constitutional Law*, 15 STAN. L. REV. 309, 320-21 (1963).

34. *Horton v. Gulledege*, 277 N.C. 353, 359, 177 S.E.2d 885, 889 (1970); Hetherington, *supra* note 28, at 226. The "law of the land" clause in the North Carolina constitution (art. I, § 19) is often said to be synonymous with the federal "due process" clause; *e.g., Charles Stores Co. v. Tucker*, 263 N.C. 710, 714, 140 S.E.2d 370, 373 (1965). Since state constitutional decisions cannot be reviewed by the Supreme Court, the clauses are not absolutely synonymous. Ironically, *State v. Ballance*, 229 N.C. 764, 51 S.E.2d 731 (1949), is routinely cited as authority for the identity of the federal and state clauses even though the substantive due process holding in *Ballance* would never have been reached under the federal clause at that time.

35. J. A. C. Hetherington uses a statement from the Supreme Court's 1932 opinion, *New State Ice Co. v. Liebman*, 285 U.S. 262, 278 (1932), as an example:

"Nothing is more clearly settled than that it is beyond the power of a state under the guise of protecting the public, arbitrarily to interfere with private business or prohibit lawful occupations or impose unreasonable or unnecessary restrictions upon them."

. . . [T]his statement, 26 years after it was made and 20 years after it was repudiated by the Court which made it, accurately describes an important principle in the constitutional law of many states.

Hetherington, *supra* note 28, at 228-29. *New State Ice Co.* was cited in *Aston Park* as authority for that same principle forty-one years after it was made and thirty-five years after it was repudiated by the Court that made it. 282 N.C. at 551, 193 S.E.2d at 735.

36. *See Paulsen, supra* note 33, at 117-18; Note, 15 STAN. L. REV., *supra* note

33. *See also Hetherington, supra* note 28, at 248-51.

federal courts play in the government of their jurisdictions.<sup>37</sup> Judicial interference at the federal level is criticized because economic regulation is primarily a matter of social and economic policy which Congress is best suited to handle. Congress, it is argued, is better able than the courts to investigate economic matters and is more responsive to political review by the electorate. At the state level, however, this criticism breaks down. Traditionally state legislatures have met in short and relatively infrequent sessions. As a result legislators were often ineffective investigators of economic policy matters, and historically they have been more susceptible to the influence of special interest lobbyists.<sup>38</sup>

Also, in contrast to the federal system, judges in many states, like legislators, are elected<sup>39</sup> in what may be fiercely contested races for office in which rival political and economic interests are represented.<sup>40</sup>

In short, state courts have played a different role than federal courts in the government of their jurisdictions. Therefore it can be argued that state courts, unlike federal courts, may appropriately review legislation substantively.<sup>41</sup> At any rate, North Carolina courts *will*

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37. A more academic argument concerns the difference between the federal Constitution and state constitutions. One of the reasons that the federal courts withdrew from substantive review of economic matters was that the federal Constitution provides no explicit protection of free enterprise. *United States v. Carolene Prods. Co.*, 304 U.S. 144, 152-53 n.4 (1938); Hetherington, *supra* note 28, at 15-16, 29. On the other hand, the North Carolina constitution, for example contains language that favors the right to work (art. I, § 1); prohibits exclusive emoluments (art. I, § 32); and discourages monopolies (art. I, § 34).

38. See Paulsen, *supra* note 33, at 117-18. See also Hanft & Hamrick, *Haphazard Regimentation under Licensing Statutes*, 17 N.C.L. REV. 1, 3 (1938).

39. E.g., N.C. CONST. art. IV, § 16.

40. Although recent races for seats on the North Carolina Supreme Court have not been heated, an example drawn from earlier times shows the potential for political review of the North Carolina judiciary. See, e.g., H. LEFLER & A. NEWSOME, *THE HISTORY OF A SOUTHERN STATE, NORTH CAROLINA* 567 (3d ed. 1973). "The 1902 contest for Chief Justice of the state Supreme Court overshadowed all others and 'precipitated a fight which for bitterness has never been surpassed in the political annals of the state.'" *Id.* The successful candidate, Walter Clark, was an outspoken opponent of "monopolies, trusts, combines, and railroad domination." He denounced railroads among other reasons, for "legislative lobbying, and interfering in the politics of both parties." *Id.* But cf. N.C. CODE OF JUDICIAL CONDUCT, Canon 7, prescribed in 283 N.C. 771, 779 (1973). For an idea of the political impetus for Clark's judicial treatment of railroads and monopolies, see, e.g., *Atlantic Coast Line R.R. v. City of Goldsboro*, 155 N.C. 356, 71 S.E. 314 (1911); *Leavell v. Western Union Tel. Co.*, 116 N.C. 211, 21 S.E. 391 (1895). See generally BROOKS, *WALTER CLARK, FIGHTING JUDGE* 223-38 (1944).

41. Paulsen, *supra* note 33, at 117-18. Paulsen, however, criticizes courts on this ground, arguing that the appropriate remedy is to make the legislature more responsive to the people, for example, by holding legislative sessions more frequently (now the case in North Carolina). Furthermore, Paulsen argues that judicial interference causes legislative irresponsibility. *Id.*

review policy decisions of the legislatures to a greater extent than the federal courts.<sup>42</sup> Moreover, they will sometimes inquire into the motives of the legislature and look behind the stated purpose of legislation to its social and political background.<sup>43</sup>

The different roles of the federal and state courts in reviewing economic legislation arguably serve a useful function in the federal system. Since the Supreme Court has a nationwide effect on legislation through the fourteenth amendment, it cannot lightly strike down attempts at regulation. National and state policy-makers might thereby be foreclosed from reacting creatively to developing social problems. Nevertheless, since there is merit in protecting individual economic freedom against advantaged groups favored by local legislatures, some judicial control should be exercised. Courts at the state level can most effectively exercise that control since they are more likely aware of unstated legislative purposes and more sensitive to local conditions requiring regulation. In addition, state court precedent will not hamstring appropriate regulation across the country.<sup>44</sup>

### C. *North Carolina Cases—Occupational Licensing*

Whether justified or not, North Carolina's supreme court has never completely relinquished the prerogative to review economic legislation and protect individual contractual and proprietary rights. Just after the Supreme Court decided *Nebbia v. New York*<sup>45</sup> and began its withdrawal from the field, the Supreme Court of North Carolina, in a series of opinions written by Justice Seawell,<sup>46</sup> redefined the circumstances under which it would continue to substantively review economic regulation. The key cases were: *Ely Lilly & Co. v. Saunders*, written in 1939, upholding the North Carolina Fair Trade Act;<sup>47</sup> *State v. Harris*, a 1940 opinion that overturned statutory licensing of

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42. See, e.g., *State v. Harris*, 216 N.C. 746, 752, 6 S.E.2d 854, 858-59 (1940).

43. See *Roller v. Allen*, 245 N.C. 516, 525, 96 S.E.2d 851, 859 (1957); Pollitt & Strong, *Constitutional Law, Survey of North Carolina Case Law*, 45 N.C.L. REV. 855, 890-91 (1967); cf. *State v. Whitaker*, 338 N.C. 353, 360, 45 S.E.2d 860, 866 (1947); note 106 *infra*.

44. See Hetherington, *supra* note 28, at 248-51.

45. 291 U.S. 502 (1934).

46. *Ely Lilly & Co. v. Saunders*, 216 N.C. 163, 4 S.E.2d 528 (1939); *State v. Harris*, 216 N.C. 746, 6 S.E.2d 854 (1940); *Cox v. City of Kinston*, 217 N.C. 391, 8 S.E.2d 252 (1940); *State v. Whitaker*, 228 N.C. 352, 45 S.E.2d 860 (1947) *aff'd*, 335 U.S. 525 (1949). See also *Morris v. Holshouser*, 220 N.C. 293, 17 S.E.2d 115 (1941) (opinion by Devin, J.).

47. 216 N.C. 163, 4 S.E.2d 528 (1939).

dry cleaners and became a leading case in the country on the issue of licensing ordinary professions;<sup>48</sup> and *State v. Whitaker*, which confirmed the constitutionality of the "right to work" law in 1947.<sup>49</sup> Decisions on these issues—fair trade acts, occupational licensing, and right to work laws—are treated by the commentators as key indicators of the "due process" philosophy of a court.<sup>50</sup> A reading of the North Carolina cases—*Saunders*, *Harris*, and *Whitaker*—demonstrates that Justice Seawell fully appreciated this aspect of the issues before him.

In *Saunders* and *Whitaker* the court decided to uphold the legislation even though more militant, free-enterprise courts had overturned such laws.<sup>51</sup> Nevertheless, the North Carolina Supreme Court refrained from adopting the wholly permissive "due process" philosophy of the Supreme Court. For example, although *Saunders* was decided consistently with *Nebbia v. New York* the North Carolina Supreme Court mentioned *Nebbia* only to distinguish it.<sup>52</sup> In *Saunders* and *Whitaker* the court attempted to redefine its relationship to the legislature after *Nebbia*, but on different terms from those enunciated in that case:

We have nothing to do with the expediency of an economic experiment. Discussions of this subject . . . has [sic] left the law-making bodies and most of the courts convinced *that there is a field here in which the protection of private right and the promotion of the public welfare are not in irreconcilable conflict*. The statute represents an attempt of the General Assembly to harmonize and apply these principles.<sup>53</sup>

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48. 216 N.C. 746, 6 S.E.2d 854 (1940).

49. 228 N.C. 352, 45 S.E.2d 860 (1947), *aff'd*, 335 U.S. 525 (1949).

50. See Hetherington, *supra* note 28, at 229-48; Paulsen, *supra* note 33, at 100-17.

51. See Note, 15 STAN. L. REV., *supra* note 33, at 320.

52. *Ely Lilly & Co. v. Saunders*, 216 N.C. 163, 178, 4 S.E.2d 523, 538 (1939).

53. *Id.* at 181-82, 4 S.E.2d at 540 (emphasis added). In the context of a "public purpose" (see note 12 *supra*) case, the court said:

The legislature does not assume the judicial power in declaring the public policy with regard to conditions which it finds to be detrimental to the public interest, socially, economically, or politically, so long as it stays within the limits of the Constitution and invades no naturally inalienable right. The Court does not sit at the entrance of the legislative hall, but rather at the exit. It takes the ball on the rebound. Nor does the judicial power extend to the determination of abstract questions before these settle down concretely upon some person and give him a justiciable cause. Legislative discretion exercised within the broad field of power reserved to the people outside of constitutional limitations is not judicial in its nature but operates by fiat. The findings in the preamble are of this nature. It is not required of us to give them judicial approval either before or after the fact of their enactment.

The policy of the law involves a legislative discretion which is not subject to review. As pointed out in *Lilly & Co. v. Saunders* . . . this Court has

The elasticity of these restrictions on use of police power is the life-giving elasticity of the Constitution itself so vital to our economic, social, and political growth. . . . The dictates of the Fourteenth Amendment, that "the means selected shall have a real and substantial relation to the object sought to be obtained," must be viewed in the light of contemporary conditions under which the Legislature has seen fit to enact the statute in question.<sup>54</sup>

Between *Saunders* and *Whitaker* came *State v. Harris*,<sup>55</sup> a test of the constitutionality of occupational licensing for dry-cleaners. This case most clearly illustrates the differing roles that North Carolina and federal courts have chosen to play in the review of economic legislation.<sup>56</sup>

In 1940 occupational licensing particularly concerned the North Carolina Supreme Court and state courts generally.<sup>57</sup> Justice Seawell makes this clear early in *Harris*:

[C]ontroversies in the courts have arisen as to whether the organization [state licensing agency for dry-cleaners] has captured a sufficient *quantum* of public purpose to operate as an agency of the government, or whether the police power of the State, ostensibly exercised for a public purpose, is not really farmed out to a private group to be used in narrowing the field of competition, or in aid or exploitation by creating remunerative positions in administration. . . . Without the aid of the statute these groups would be

nothing to do with the propriety of an economic experiment. It seems to us clear, however, that a definite relation has been established between the prevalence of crime, often the result of human misery and neglect, and conditions which it is the purpose to this legislation to remove.

Cox v. City of Kinston, 217 N.C. 391, 398, 8 S.E.2d 252, 258 (1940).

54. *State v. Whitaker*, 228 N.C. 352, 360, 45 S.E.2d 860, 867 (1947).

55. 216 N.C. 746, 6 S.E.2d 854 (1940). *Harris* and *State v. Ballance*, 229 N.C. 764, 51 S.E.2d 731 (1949), a subsequent licensing case that will be discussed *infra*, were quoted by the supreme court in the *Aston Park* decision.

56. For an indication that federal courts would have handled *Harris* differently, cf. *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955).

57. The issue had been before the court only two years earlier in *State v. Lawrence*, 213 N.C. 674, 197 S.E. 586 (1938), *overruled in State v. Ballance*, 229 N.C. 764, 51 S.E.2d 731 (1949). In its opinion the court briefly reviewed licensing statutes and prior North Carolina cases before upholding licensing requirements for photographers. Photography was held to be a permissible object of such regulation because of dangers from fire hazards posed by the chemicals used in the profession and because of the potential for fraud in the use of "dishonest" or "careless" photography. Justice Barnhill wrote a strong dissenting opinion. Justice Seawell, then newly appointed to the court, joined the dissent. After *Lawrence* but before *State v. Harris* was decided, the Hanft and Hamrick article appeared. See note 60 and accompanying text *infra*. Hanft and Hamrick rigorously criticized *Lawrence* which they maintained gave a "judicial green light and go" signal for such legislation. Hanft & Hamrick, *supra* note 38, at 16-18.

mere trade guilds, or voluntary business associations; with it they become State agencies . . . .<sup>58</sup>

The court plainly felt that the motley collection of licensing statutes which had by then accumulated in North Carolina law abused governmental authority. Many of the statutes represented no more than protectionist legislation.<sup>59</sup> In reaching this view the court had been significantly influenced by an article which it cited in its opinion, *Haphazard Regimentation under Licensing Statutes*, by Professor Hanft and J. N. Hamrick.<sup>60</sup> The article was a powerful attack on the piecemeal state of North Carolina law in this area. Since the legislature had failed "to shoulder the job of bringing orderly, well-considered law out of [the] present haphazard regimentation," Hanft and Hamrick argued that the courts should deal at least with the licensing statutes already adopted.<sup>61</sup>

Just as he had done in *Saunders*, Justice Seawell in *Harris* raised the question of the significance of *Nebbia*. In both cases Justice Seawell indicated that he desired to work out a similar but more limited readjustment of the doctrine for North Carolina. The Attorney General had argued that *Nebbia* presaged courts' yielding to legislatures "the ultimate determination of the relative importance of the social interests involved in maintaining or overruling applicable constitutional guaranties."<sup>62</sup> Justice Seawell responded that if the courts so capitulated they could never protect the rights of men in the simplest trades from the grossest aggressions against their freedoms. He stressed that the legislature could not validly exercise the police power to restrict entry into an occupation as ordinary and harmless as dry

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58. 216 N.C. at 752, 6 S.E.2d at 858-59 (citations omitted). See generally Friedman, *supra* note 32.

59. 216 N.C. at 752, 6 S.E.2d at 858-59. See generally Hanft & Hamrick, *supra* note 38. Licensing statutes had been enacted to regulate as many as fifty-three occupations ranging "from the most important professions to the most obscure trades." *Id.* at 2. In the case of "ordinary" trades or professions the statutes typically required that applicants pass technical examinations and reviews of their moral qualifications before they were permitted to enter the trade or profession.

60. 17 N.C.L. REV. 1 (1938). The article has been cited regularly since *Harris* in decisions in which the court strikes down licensing statutes.

61. *Id.* at 9. For an idea of later efforts by the legislature to "shoulder the job" see Note, *Licensing Board—Police Power Limitation Thereon*, 27 N.C.L. REV. 532 (1949); Note, *Constitutionality of Statutes Licensing Occupations*, 35 N.C.L. REV. 473 (1957). See generally Barron, *Business and Professional Licensing—California, A Representative Example*, 18 STAN. L. REV. 640 (1966); Silverman, Bennett & Lechliter, *Control by Licensing Over Entry into the Market*, 8 LAW & CONTEMP. PROB. 234 (1941); Wallace, *Occupational Licensing and Certification: Remedies for Denial*, 14 WM. & MARY L. REV. 46 (1972).

62. *State v. Harris*, 216 N.C. 746, 756-57, 6 S.E.2d 854, 861 (1940).

cleaning. The real purpose behind the law, he said, was not protection of the public but the advancement of the interests of established dry-cleaners. For Justice Seawell and the majority, the new philosophy represented by *Nebbia* did not portend the end to judicial review of economic legislation; rather it signaled an expansion of the scope of legislative discretion in the context of post-Depression social and economic history.<sup>63</sup>

In *Harris*, just as in *Saunders*, the court was not hostile to the position taken by the United States Supreme Court in *Nebbia*. But the court was unwilling to abdicate completely its role in the review of economic legislation. The effect of the new due process philosophy of the North Carolina court, therefore, was only to give a "new adjustment between social demands and constitutional restraint."<sup>64</sup> To this end Justice Seawell enunciated a test to indicate the scope within which legislative "experiments" were permissible:

[R]egulation of a business under the police power must be based on some distinguishing feature in the business itself or the manner in which it is ordinarily conducted, the natural and probable consequence of which, if unregulated, is to produce substantial injury to the public peace, health, or welfare.<sup>65</sup>

Justice Seawell's test, like other "rules of reason," boils down to a subjective judicial determination. A key feature of the Seawell formulation, though, is the distinction it draws between the regulation of an ordinary profession or business and one which is "of such character as places it within the category of social and economic ills."<sup>66</sup> This distinction makes it clear that in retaining a measure of substantive review the purpose of the court was only to guard against the grosser aggressions on individual economic freedom—not to review generally the economic policy of the legislature.<sup>67</sup> Under the *Harris* test the court will not overrule economic legislation so long as the subject of the regulation is a business whose character "places it within the category of social and economic ills."<sup>68</sup> The *Aston Park* case marks

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63. *Id.* at 756-57, 6 S.E.2d at 861-62. Ultimately Justice Seawell distinguished *Nebbia* from *Harris* on its facts. *Id.* at 752, 6 S.E.2d at 862.

64. *Id.* at 751, 6 S.E.2d at 862.

65. *Id.* at 758-59, 6 S.E.2d at 863.

66. *Id.* at 759, 6 S.E.2d at 863.

67. *Id.* at 763-64, 6 S.E.2d at 865-66.

68. Of course, even regulation of a business in the latter category would be set aside if the regulation is manifestly unreasonable and bears no relation to any permissible legislative goal. Where an industry is within the category of social "ills," however, the *Harris* court would allow the General Assembly to decide as a matter of social policy whether its regulation bears a *substantial* relation to the public health, safety,

a departure from this position.<sup>69</sup>

Significantly, in neither *Saunders* nor *Harris* nor *Whitaker* was there the paean to *laisse faire* and free competition traditionally associated with substantive due process. This post-Depression court—which during the same period upheld comprehensive regulation of the banking industry, including an absolute restriction of entry into that business<sup>70</sup>—seemingly was aware of the demise of *laissez faire* as a policy protected by the Constitution and was willing to see it go. Although the *Harris* court set aside the legislation before it, its philosophy was articulated in terms rather different from those of *laissez faire*.<sup>71</sup> The dry cleaning statute was overturned not because it interfered with regulation of the market-place through competition but because it interfered with the right of citizens to enter the ordinary trades and professions freely. The limitations on entry into the dry cleaning business could have been justified upon a showing that some feature of the industry threatened public harm. Dry cleaning, however, was found to be an ordinary trade, threatening no harm to the public. That being so, the court saw restriction of entry into the trade as a device intended solely to protect established dry cleaners from competition.<sup>72</sup>

In the years since *Harris*, the supreme court has not been as careful to avoid endorsing free competition as the best policy for regulation of the market place.<sup>73</sup>

or welfare. If the industry is within the category of "ills" no reasonable (*i.e.* not manifestly unreasonable) regulation will be a "gross aggression" of individual freedom.

69. See text accompanying notes 92-102 *infra*.

70. *Pue v. Hood*, 222 N.C. 310, 22 S.E.2d 896 (1942).

71. There is a definite obligation of law to progress which should not be ignored in the interpretation of the Constitution. But the liberal formulae in which this relation is usually expressed are mere abstractions when applied to the instant case. It has not been made to appear that progress has made any substantial change between those engaged in the occupation under consideration and those whom they serve that would require a reappraisal of the Constitution.

216 N.C. at 762, 6 S.E.2d at 865.

72. *Id.* at 762, 6 S.E.2d at 864. *Harris* is a particularly earnest attempt to readjust the roles of court and legislature in determining social policy. The court adamantly refuses to relinquish its role, but at the same time it is equally concerned not to hinder legislative response to social and economic problems. See *id.* at 764, 6 S.E.2d at 866. See generally Comment, 1 DUKE B.J., *supra* note 33.

73. Although the case was decided on other grounds, the court in *State v. Mobley*, 234 N.C. 55, 69, 66 S.E.2d 12, 22 (1951), tossed off the following dictum: "It is enough to say that these protective safeguards,—counterparts of the Federal due process and equal protection clauses,—still stand as sentinels in the marketplace, ever vigilant and ready to lift stifling burdens from the portals of those who in fair competition make the better mouse traps."



In fact, in its next occupational licensing case, *State v. Ballance*,<sup>74</sup> the court endorsed unfettered competition.<sup>75</sup> Nonetheless, *Ballance* was essentially an application of the principles developed in *Harris* to another ordinary profession—photographers. Subsequent licensing decisions followed the pattern set by *Harris* and *Ballance*. Cases in which statutes have been overturned involved ordinary or innocuous professions, and the court has shown a continuing suspicion of the special interests of established licensees.<sup>76</sup> Although the foregoing factors generally determine the outcome of the cases, from time to time the court has adverted to the merits of free competition.<sup>77</sup> Generally, the occupational licensing cases are the only ones in which substantive review of economic regulation has retained very much vitality.<sup>78</sup> Thus North Carolina's supreme court has a tradition of upsetting legislative decisions on grounds of social and economic policy in only a relatively narrow range of cases.<sup>79</sup> Where substantive review of licensing statutes is undertaken, the court's emphasis is on the in-

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74. 229 N.C. 764, 51 S.E.2d 731 (1949), *overruling* *State v. Lawrence*, 213 N.C. 674, 197 S.E. 586 (1938).

75. At issue again was the constitutionality of the licensing statute for photographers. *See* note 57 *supra*. Although Justice Ervin, who wrote the majority opinion, noted that photography is a noble profession, he found it as well to be an innocuous one. Since there was so little danger to the public, the court found no justification for the curtailment of individual freedoms accomplished by restricting entry to the trade. Instead, it found that the restriction served only to promote the interests of a particular class—the established photographers. In addition to these considerations, Justice Ervin argued against regulation of photography by saying in effect that the appropriate policy to insure quality and to protect the public is “the economic philosophy generally accepted in this country that ordinarily the public is best served by the free competition of free men in a free market.” 229 N.C. at 771, 51 S.E.2d at 736. Chief Justice Stacy (with one justice concurring) registered a Holmes-like dissent: “Neither the constitutional prohibitions nor the legislative enactment should be made to bend to the Court's inconstant economic views or predilections.” *Id.* at 773, 51 S.E.2d at 737.

76. *See, e.g.*, *State v. Warren*, 252 N.C. 690, 114 S.E.2d 660 (1960); *Roller v. Allen*, 245 N.C. 516, 96 S.E.2d 851 (1957). *See also* Note, 35 N.C.L. REV., *supra* note 61.

77. *Roller v. Allen*, 245 N.C. 516, 523, 96 S.E.2d 851, 857 (1957).

78. *See* Comment, 1 DUKE B.J., *supra* note 33, at 58-60. For examples of “substantive due process” cases not involving occupational licensing see *Walker v. City of Charlotte*, 276 N.C. 166, 171 S.E.2d 431 (1970); *Cheek v. City of Charlotte*, 273 N.C. 293, 160 S.E.2d 18 (1968); *Clark's Greenville, Inc. v. West*, 268 N.C. 527, 151 S.E.2d 5 (1966); *J. Lampros Wholesale, Inc. v. ABC Board*, 265 N.C. 679, 144 S.E.2d 895 (1965); *State v. Smith*, 265 N.C. 173, 143 S.E.2d 293 (1965); *Charles Stores Co. v. Tucker*, 263 N.C. 710, 140 S.E.2d 370 (1965); *State v. Williams*, 253 N.C. 337, 117 S.E.2d 444 (1960); *State v. Brown*, 250 N.C. 54, 108 S.E.2d 74 (1959); *State ex rel. Milk Comm'n v. Galloway*, 249 N.C. 658, 107 S.E.2d 631 (1959). *See also* *Pue v. Hood*, 222 N.C. 310, 22 S.E.2d 896 (1942).

79. This statement does not encompass the “public purpose” cases. *See* note 12 *supra*.

nocuous nature of the profession sought to be regulated. Concern with freedom in the market place was prompted by a fear that the real reason for licensing was the attempt of private groups to prevent others from entering their profession.<sup>80</sup> Where a genuine public interest in regulation has been demonstrated, a relatively meager showing of the need for regulation has outweighed individual interests in unrestrained competition.<sup>81</sup> The argument that free competition serves the public interest better than government regulation has been present, but it has never figured centrally in a holding.

#### D. *Due Process Implications of Aston Park*

There are important differences between occupational licensing and certificate-of-need regulation,<sup>82</sup> but the court's *authority* to review economic legislation is the same for all types of regulation,<sup>83</sup> and the *Aston Park* court looked to the cases discussed above for its precedent. The specific holding in *Aston Park* was that the law of the land clause

does not permit the Legislature to authorize a State board or commission to forbid persons . . . to construct adequate facilities and to employ therein a licensed . . . staff for the treatment of sick people, who desire the service, merely because to do so endangers the ability of other, established hospitals to keep all their beds occupied.<sup>84</sup>

The court tested the certificate-of-need law by the same standard that was used in the occupational licensing cases. Stated in terms of that standard, the court found that certificates of need—or planning and control of regional hospital construction—do not bear a sufficiently substantial relation to the public health to justify denying an individual's right to engage in the business. The law failed in the court's view for two reasons. First, the court plainly felt that competition is a better means than regulation to secure the public health. Secondly, restriction of entry is an unusually severe curtailment of individual liberty, one which must be strongly justified.

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80. See Friedman, *supra* note 32, at 513. But see Barron, *supra* note 61, at 640-42.

81. See, e.g., State v. Warren, 252 N.C. 690, 114 S.E.2d 660 (1960); Pue v. Hood, 222 N.C. 310, 22 S.E.2d 896 (1942); cf. State *ex rel.* Milk Comm'n v. National Food Stores, Inc., 270 N.C. 323, 154 S.E.2d 548 (1967).

82. See text following note 102 *infra*.

83. See Boylan v. United States, 310 F.2d 493, 497 (9th Cir. 1962).

84. *In re Aston Park Hosp., Inc.*, 282 N.C. 542, 549, 193 S.E.2d 729, 734 (1973).

The court noted that in ordinary businesses "competition is an incentive to lower prices, better service, and more efficient management,"<sup>85</sup> and the Attorney General made no showing that convinced the court that hospitals are not like ordinary businesses as far as competition is concerned.<sup>86</sup> Thus the monopoly-like, non-competitive situation created by the legislature was not justified by a showing that regulation is a more effective approach for promotion of the public health than free competition. The court distinguished certificate-of-need regulation from public utility regulation because hospitals are not subject, as are utilities, to price controls which would protect the public against the consequences of monopoly.<sup>87</sup>

As to the restriction-of-entry feature of the certificate-of-need law, the court said that whether the police power has been validly exercised by the legislature is a matter of degree that is determined by measuring the nature of the regulation against the public benefit likely to result. It also stated that "[t]o deny a person . . . the right to engage in a business . . . is a far greater restriction upon his liberty than to deny the right to charge . . . whatever prices the owner sees fit to charge . . . [so that a] substantially greater likelihood of benefit to the public [must be shown]. . . ."<sup>88</sup>

In its opinion the court quoted language from several of the occupational licensing cases,<sup>89</sup> the North Carolina decisions in which economic due process retains the most vitality.<sup>90</sup> *Aston Park* suggests, however, that the court may now undertake substantive review of a wider range of legislation than it has in the past. This broadened range for judicial intervention is suggested because (1) unlike the licensing cases, *Aston Park* did not concern an ordinary or innocuous occupation; (2) more than in any other economic due process case, the *Aston Park* court affirmed its faith in the virtues of competition as an economic policy, rather than expressing a narrower sus-

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85. *Id.*

86. *Id.*

87. *Id.* at 550, 193 S.E.2d at 734-35.

88. *Id.* at 550, 193 S.E.2d at 735. A sort of sliding scale results: The more onerous the regulation, the greater the public benefit required.

89. *Roller v. Allen*, *State v. Ballance*, and *State v. Harris* were quoted but not discussed. *Cheek v. City of Charlotte*, 273 N.C. 293, 160 S.E.2d 18 (1968), not a licensing case, was cited but not discussed. In that case the court held that legislative curtailment of the individual right to engage in the massage parlor business was justified under the police power of the General Assembly to regulate morals. The parlor owner won his case on other grounds.

90. See note 78 *supra*. See generally Paulsen, *supra* note 33, at 100.

picion of an interest group attempting to insulate itself from competition<sup>91</sup> or confining its objections solely to the curtailment of the freedoms of citizens excluded from the hospital business; and (3) the court revealed that it will measure different quanta of public interest for different forms of economic regulation. Each of these aspects of the case will be discussed in turn.

1. *Hospitals an Ordinary Profession?* The *Aston Park* court recognized that "in many respects a hospital is not comparable to an ordinary business establishment." But it stated that, with respect to competition, nothing was shown to indicate that hospitals are different from ordinary businesses.<sup>92</sup> This amounts to either a policy determination by the court on the economic nature of hospitals<sup>93</sup> or a presumption that free competition will be the preferred economic policy for industry in North Carolina unless the legislature shows that another policy is superior. The court's use of the word "ordinary" in *Aston Park* is entirely different from the use of that word in occupational licensing cases. "Ordinary" in those cases was the substantial equivalent of "innocuous."<sup>94</sup> As previously noted, the rationale behind the ordinary/not-ordinary distinction was that ordinary professions, if left unregulated, posed no threat of injury to the public health, safety, or welfare. If a profession were found to be non-ordinary or non-innocuous, the General Assembly might in its discretion

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91. Although the court expressed no specific suspicion that the certificate-of-need law represented an attempt by the hospital industry to insulate itself from competition, circumstantial grounds existed for such a suspicion. The legislative history of the bill shows no adverse treatment at all. It was introduced, passed through the committees, and enacted without amendment.

The matter had not been considered by the Legislative Research Committee on Health. Furthermore, the American Hospital Association apparently supported the laws with some enthusiasm; see Drake, *Public Utility, Its Meaning for Hospitals*, TRUSTEE, April 1973, at 1; Somers, *Only the Hospital Can Do It All—Now*, MOD. HOSP., July 1972, at 97; cf. Paulsen, *supra* note 33, at 117; Strong, *supra* note 28, at 889-91. Professor Havighurst, writing just after the law was enacted, had said that measures such as the North Carolina one were being "silently metamorphosed into protectionist regulation for the benefit of incumbent providers." Havighurst, *Foreword to Health Care: Part II*, 35 LAW & CONTEMP. PROB. 667 (1970). See also Havighurst, *Health Maintenance Organizations and the Market for Health Services*, 35 LAW & CONTEMP. PROB. 716, 759, 785 (1970); cf. note 189 *infra*.

92. 282 N.C. at 549, 193 S.E.2d at 734.

93. Whether the hospital industry is like ordinary industries insofar as competition is concerned is a question over which there is considerable debate. For contrasting viewpoints, see Havighurst, *Health Maintenance Organizations and the Market for Health Services*, 35 LAW & CONTEMP. PROB. 716 (1970). Fuchs, *What Kind of System for Health Care?*, 45 BULL. N.Y. ACAD. MED. 281 (1969).

94. "But it is otherwise with respect to the ordinary lawful and innocuous occupations of life." *State v. Ballance*, 229 N.C. 764, 770, 51 S.E.2d 731, 735 (1945).

determine the regulation best suited to protect the public interest without interference by the court. Where professions were ordinary, however, no scope existed for legislative discretion because no public interest justified curtailing the individual right to work.<sup>95</sup>

Hospitals manifestly are not "ordinary" or "innocuous." Both the manner in which they are operated and the problem of regional bed capacity have entered the category of "social and economic ills."<sup>96</sup> Bed capacity is a factor in the distribution of medical resources which in turn determines the quality, quantity, and cost of medical care.<sup>97</sup>

Moreover, medical and related professions are universally viewed as having an immediate impact on the public health, and one commentator notes that state courts generally have countenanced almost any legislative regulation in these fields.<sup>98</sup> Nevertheless, the North Carolina Supreme Court concluded, that for purposes of competition hospitals are like ordinary businesses.<sup>99</sup> To do so, however, is to make a choice among competing economic policies that the courts have heretofore been unwilling to make. The implication is that the supreme court will closely review legislative regulation in a wider range of professions than it ever has done in the past.<sup>100</sup>

It bears noting at this point that although couched in a different vocabulary, the distinction between "ordinary" professions and "so-

95. *State v. Ballance*, 229 N.C. 764, 770-771, 51 S.E.2d 731, 735 (1949); *State v. Harris*, 216 N.C. 746, 759, 6 S.E.2d 854, 863 (1940).

96. See cases cited notes 10 & 81 *supra*; text accompanying note 25 *supra*; Havighurst, *supra* note 24; Note, *Unplanned and Uncoordinated Development of Hospital Facilities—A Need for Legislation*, 52 IOWA L. REV. 1187 (1967); cf. Barron, *supra* note 61.

97. See text accompanying notes 135-38 *infra*.

98. Hetherington, *supra* note 28, at 229-30.

99. On policy grounds the point is debatable, see note 102 *infra*.

100. Although that range of cases is surely limited to those in which individuals are denied the right to work, an illustration of the widened range comes to mind. N.C. GEN. STAT. §§ 14-423 to -424 (1969) prohibits the practice of professional debt adjustment. For the United States Supreme Court's treatment of such laws, see *Ferguson v. Skrupa*, 372 U.S. 726 (1963). Under the North Carolina precedents there is little justification for arguing that the legislation is unsound. The profession would not be considered innocuous because of its potential to harm unwary debtors, see *State v. Warren*, 252 N.C. 690, 114 S.E.2d 660 (1960), so that legislative decisions about how to regulate it could be expected to be given great weight against the arguments of a plaintiff claiming he was denied due process because he was excluded from the business. Were free competition not an end in itself, total prohibition would be unobjectionable since no special interests would be served. After *Aston Park*, however, a debt adjuster might argue that even though his profession is not harmless, the public interest justifies only regulation of practices, or rates—not total prohibition. Free competition, he could argue, will ensure quality service to the extent required by the public interest; see *State v. Ballance*, 229 N.C. 764, 771, 51 S.E.2d 731, 736 (1949). See generally *Adams v. Tanner*, 244 U.S. 590 (1917).

cially ill" ones is familiar to economists. In economic terms "ordinary" professions are those in which many independent providers compete and in which there are few natural barriers to entry into the business (e.g., a large capital investment). The public, in dealing with those industries, has relatively strong bargaining power. Therefore such industries are ideally structured for efficient regulation of supply and prices by open-market competition. Where industries are not so structured—where a few large providers serve consumers who have limited market power—unregulated competition is not calculated to ensure efficient and equitable allocation of resources. If not regulated, those industries have the potential to cause public harm through the monopoly or oligopoly power of the providers. Viewed economically those industries would not be "ordinary."<sup>101</sup>

The language in *Aston Park* to the effect that hospitals are like other industries as far as competition is concerned amounted to a finding that hospitals are "ordinary" in this sense. That judgment finds little support among students of the hospital industry.<sup>102</sup> The real problem with the *Aston Park* finding, however, is that on economic grounds occupational licensing cases furnish no precedent for regulating entry into the hospital industry. The focus in the licensing cases was on quality of service. Competition in "ordinary" professions can be relied on to ensure acceptable standards of service because there is so little threat of harm in the first place.

In *Aston Park*, on the other hand, the question was not quality of service, which is already extensively regulated in hospitals, but allocation of resources. Resources are allocated efficiently if the resources invested in an industry match the public demand—or need—for that industry's product. Competition makes that match very well in the case of "ordinary" professions because of the low fixed costs necessary to provide those services. If an oversupply of dry cleaners occurs, the surplus resources invested in dry cleaning can be reinvested in other professions with little waste. The buildings used for dry cleaning, for example, can readily be converted to other uses. Even if there are non-convertible resources their worth is relatively small.

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101. See generally R. POSNER, *supra* note 32, at 104-13, 266-72; Strong, *supra* note 28; Verkuil, *The Economic Regulation of Taxicabs*, 24 RUTGERS L. REV. 672, 681 (1970).

102. See Rothenberg, *Comment to Carr, Economic Efficiency in the Allocation of Hospital Resources: Central Planning vs. Evolutionary Development*, in *EMPIRICAL STUDIES IN HEALTH ECONOMICS* 222-28 (H. Klarman ed. 1970). See also notes 134, 182, 186 *infra*.

In contrast, the hospital industry is characterized by huge fixed costs devoted to property that cannot be converted to other uses. Where oversupply occurs substantial waste stands to take place.

2. *Competition Guaranteed by the Constitution?* *Aston Park* does not simply argue that a free market assures individual freedom to work. Free competition, the court said, produces desirable social and economic results—lower prices, better service, etc.—apart from any relation to the right to work.<sup>103</sup> Furthermore, a sort of presumption seems to exist in favor of free competition. Where legislative restraints on competition are at issue, future proponents of regulation must convince the court that regulation will achieve results superior to those which may be expected from free competition. Lengthy “Brandeis briefs”<sup>104</sup> may be the response as lawyers try with economic and social data, studies, and theories to carry the burden of demonstrating that legislative regulation—not *laissez faire*—is the best way to deal with a social problem.<sup>105</sup> The conventional objection to courts engaging in this sort of review is that the legislative branch is more competent to make that kind of inquiry.

Perhaps a critical failing of the North Carolina certificate-of-need law was that the legislature did not undertake a formal policy study itself before enacting the statute. Had a legislative research commission thoroughly studied the proposal before it was introduced and published detailed findings, the court might have been less ready to set aside the resulting law. There are indications that the North Carolina court will consider such reports for some purposes, and if such a report outlined the policy considerations underlying legislation, the court might be less willing to replace legislative policy with its own even where the court engages in substantive review.<sup>106</sup> Since

103. 282 N.C. at 549, 193 S.E.2d at 734.

104. *Muller v. Oregon*, 208 U.S. 412, 419-21 (1908), discussed in A. MASON, BRANDEIS, A FREE MAN'S LIFE 248-52 (1946).

105. See, e.g., *Roller v. Allen*, 245 N.C. 516, 519, 96 S.E.2d 851, 854 (1957). See also Bicklé, *Judicial Determination of Questions of Fact Affecting the Constitutional Validity of Legislative Action*, 38 HARV. L. REV. 6 (1924).

106. When the General Assembly undertakes economic legislation a legislative research commission report can be of value in court as well as having its obvious uses prior to passage of the statute. Once the broad doctrine of the North Carolina Supreme Court was that “no evidence as to the motives of the Legislature can be heard,” and that legislative intent must be determined within the “four corners” of a legislative act. *D & W, Inc. v. City of Charlotte*, 268 N.C. 577, 581, 151 S.E.2d 241, 244 (1966) (an affidavit from a legislator is not competent evidence of legislative intent). That doctrine has been qualified, however, in at least the following instances:

(a) Perhaps a general rule which replaces the “four corners” rule was set forth in *State ex rel. Milk Comm'n v. National Food Stores*, 270 N.C. 323, 332, 154 S.E.2d

there was no report by a research commission, and since the legislative history of the bill showed that no amendments were introduced, the certificate-of-need law was vulnerable to attack as special interest legislation.<sup>107</sup> In any event, there were few political considerations to constrain the court from overturning the statute.

3. *Police Power a Question of Degree.* According to the *Aston Park* court, different forms of economic regulation must be justified by different quanta of public interest. The degree of public interest must correspond to the degree to which the regulation restricts eco-

548, 555 (1967), "[Legislative] intent must be found from the language of the act, its legislative history and the circumstances surrounding its adoption which throw light upon the evil sought to be remedied." *Accord, In re Indian Hills*, 280 N.C. 659, 664, 186 S.E.2d 909, 912 (1972). *See generally* *State v. Waddell*, 282 N.C. 431, 441-42, 451, 455-57, 460, 476, 194 S.E.2d 19, 26, 46, 32-33, 35, 48 (1973).

(b) "Where the meaning of a statute is doubtful the history of the legislation may be considered in connection with the object, purpose, and language of the statute in order to arrive at its true meaning." *Lithium Corp. of America v. Bessemer City*, 261 N.C. 532, 536, 135 S.E.2d 574, 577 (1964). In *Lithium Corp.* the court consulted the report of a legislative study commission to determine the interpretation of ambiguous language in a statute. *Accord, Ingram v. Johnson*, 260 N.C. 697, 699, 133 S.E.2d 662, 664 (1963).

(c) Where there is danger that powerful interest groups have secured protectionist legislation, the court sometimes looks to the social and economic background of legislation before it. *See Roller v. Allen*, 245 N.C. 516, 525, 96 S.E.2d 851, 859 (1957); *Pollitt & Strong*, *supra* note 43, at 890-91; *cf. State v. Whitaker*, 228 N.C. 353, 360, 45 S.E.2d 860, 866 (1947).

(d) In *Allred v. City of Raleigh*, 277 N.C. 530, 178 S.E.2d 432 (1971), the supreme court overturned a zoning ordinance on the basis of evidence drawn from the city council's minutes. Although the ordinance was unobjectionable on its face and although the city council was considered a "legislative body" within the grant of the enabling legislation, evidence drawn entirely from the minutes disclosed that in passing the ordinance the council had disregarded "fundamental concepts of zoning as set forth in the enabling legislation." *Id.* at 545, 178 S.E.2d at 440.

Legislative research commission reports are the first evidence a court might consult outside the "four corners" of a statute. Where economic regulation is subject to substantive attack such reports might serve several purposes. First, since the court must necessarily evaluate policy determinations as they affect the public interest, the report could demonstrate at length the social and economic justifications for specific regulations. Recitals of sources consulted and discussions of alternatives rejected would negate inferences of protectionism and demonstrate the perceived necessity for restriction of market freedoms. (This would respond to the matters discussed in the text accompanying footnotes 91 & 96 *supra*.) Secondly, as in the *Lithium Corp.* case, the report would be a source of explanation for ambiguous terms in the statute. Finally, even if the court refuses to consult the reports for evidence of legislative motive or intent on the basis of one of the reasons suggested above, the material contained in them is a valuable resource for the parties, serving to sharpen advocacy of competing policy positions. Without such a reference, counsel on either side might lack the resources to research a complex economic question thoroughly; thus the court would be deprived of comprehensive discussions of the legislation in briefs and oral debate.

107. *See* note 91 *supra*. For an example of a research commission report see TENNESSEE LEGISLATIVE COUNCIL, *supra* note 16.



conomic freedom.<sup>108</sup> By the court's measure, rate regulation is a lesser invasion of market freedom than entry controls; thus presumably the legislature may impose rate controls in a wide range of activities of lesser public importance.<sup>109</sup> In contrast, exclusion of entry into the market is a major curtailment of freedom; therefore a much larger measure of public interest must justify that sort of regulation. The court's analysis simply makes explicit the subjective process by which courts must always measure reasonableness.<sup>110</sup> The United States Supreme Court has minimized the subjectivity of such determinations on its part by interpreting its "rule of reasonableness" as broadly as logic will allow. Before that Court, economic regulation is constitutionally permissible if any state of facts can be conceived to justify the legislature's judgment.<sup>111</sup> The North Carolina Supreme Court, of course, has never gone that far. It must be satisfied that a "substantial" connection exists between the legislation and a permissible legislative object.<sup>112</sup> This leaves room for judicial review in a broader range of policy matters.

The *Aston Park* decision suggests an expansion of that range. The court acted outside the area of "ordinary" industries and made a new inquiry. Heretofore the judicial inquiry was simply, "Is there sufficient public interest to justify the regulation?" In *Aston Park* the court decided that the public interest in hospitals is not enough to justify a certificate-of-need law but suggested that it probably is sufficient to warrant rate regulation. To make such fine distinctions and, in effect, to suggest "less restrictive" alternatives is to thrust the court into the nuts and bolts of legislative policy-making.<sup>113</sup>

The broad implications of *Aston Park* may be limited by its facts in one important respect. Unlike conventional licensing or price regulation, certificate-of-need regulation absolutely excludes even qualified individuals from the regulated business on the basis of a circumstance over which individuals have no control—public need. "The door is [not] open to all who possess the requisite competency, good character and can pass the examination . . ."<sup>114</sup>

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108. 282 N.C. at 550, 153 S.E.2d at 734-35.

109. *But cf.* Strong, *supra* note 28, at 428: "Under the classical economic theory of Adam Smith . . . price was central."

110. *See* State v. Harris, 216 N.C. 746, 759, 6 S.E.2d 854, 863 (1940).

111. *Williamson v. Lee Optical Co.*, 348 U.S. 483, 488 (1955).

112. *See* text accompanying note 27 *supra*; Strong, *supra* note 33, at 946-47.

113. *Cf.* Paulsen, *supra* note 33, at 117-18. *But see* Struve, *supra* note 28.

114. *State v. Warren*, 252 N.C. 690, 697, 114 S.E.2d 660, 666-67 (1960).

The exclusion based on need sets *Aston Park* apart from the licensing decisions which are primarily concerned with the regulation of quality of service and suggests a comparison with cases that concern the allocation and distribution of societal resources—the sort of issue generally treated in the context of utility regulation.<sup>115</sup> The due process standard in the utility cases is essentially the same one used in licensing cases. Legislation must be substantially related to the public interest.<sup>116</sup> But this is an area in which the courts have granted the legislature wide latitude to make decisions about regulatory measures.<sup>117</sup>

The court might have fashioned a relatively narrow holding from the monopoly aspect of *Aston Park*. Without discussing competition in terms of its economic benefits, the court might have decided that the privilege of quasi-monopoly status cannot be granted without a corresponding regulation of prices to protect the public against the consequences of monopoly.<sup>118</sup> Such a holding could have been supported by reasoning from their traditional suspicion of special interest legislation.<sup>119</sup> Then the way would clearly have been left open to the legislature, if it chose, to regulate the hospital industry as it does public utilities or banks. This was not the holding of *Aston Park*, however. The court distinguished utility regulation and based its holding on the competition and right to work arguments discussed above. For that reason the door seems closed to any regulation of hospitals that incorporates a statutory monopoly even if rate controls are also included in the scheme.<sup>120</sup>

The holding of the *Aston Park* decision was not *expressly* limited in any way to the absolute exclusion feature of the regulatory scheme

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115. See *Nebbia v. New York*, 291 U.S. 502, 528 (1934); *New State Ice Co. v. Liebmann*, 285 U.S. 262, 282 (1932) (Brandeis, J., dissenting); cf. *Pue v. Hood*, 222 N.C. 310, 22 S.E.2d 896 (1942).

116. See text accompanying note 161 *infra*.

117. See *Candler v. City of Asheville*, 247 N.C. 398, 101 S.E.2d 470 (1958); *In re Southern Pub. Util. Co.*, 179 N.C. 151, 101 S.E. 619 (1919); *Atlantic Coast Line R.R. v. City of Goldsboro*, 155 N.C. 356, 71 S.E. 514 (1911), *aff'd*, 232 U.S. 548 (1914).

118. See *State ex rel. Utilities Comm'n v. Carolina Coach Co.*, 260 N.C. 43, 51, 132 S.E.2d 249, 254-55 (1963); *State ex rel. Utilities Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 548, 119 S.E.2d 469, 477 (1961); *State ex rel. Utilities Comm'n v. State*, 239 N.C. 333, 343, 80 S.E.2d 133, 140 (1954); text accompanying notes 190-93 *infra*. But see *Davies Warehouse Co. v. Brown*, 137 F.2d 201, 216 (Emer. Ct. App. 1943) (Vinson, C.J., dissenting), *rev'd*, 321 U.S. 144 (1944), in which Judge Vinson observes that price regulation is not a necessary concomitant of utility status.

119. See note 43 *supra*.

120. See text following note 190 *infra*.

established by the legislature. The same reasoning could be employed to set aside any regulation that restricts entry into a business or occupation.<sup>121</sup> Still, there is some basis for arguing that the precedential value of *Aston Park* does not extend far beyond cases in which individuals are denied entry to sectors of the economy on the basis of factors beyond their control. Although the court spoke in terms of the benefits of competition, its concern was prompted by the monopolistic nature of the certificate-of-need law. Also the sliding scale set up by the court to counterbalance regulation and public interest leaves room for lesser restraints on competition to be balanced by a lesser public interest. Furthermore, the newly demonstrated willingness to review regulation of not-ordinary businesses must be viewed in light of the compulsion felt by the court to resist absolute exclusions from the business especially where they are unaccompanied by price regulation or other protections for the public against the consequences of monopoly.<sup>122</sup>

It can be justifiably argued that the *Aston Park* decision has no significance beyond the field of hospital regulation. Within a relatively short time the North Carolina Supreme Court heard the Medical Care Commission argue that Asheville had too many hospital beds and in *Foster* that Raleigh had too few. In view of the absence of a legislative research commission report and the failure to find a "public purpose" in *Foster*, the holding in *Aston Park* may simply reflect a conviction that the time has not yet come to involve the government in comprehensive regulation of hospitals.<sup>123</sup>

### III. HOSPITAL REGULATION

If *Aston Park* has no effect outside the field of hospital regulation, its impact will be very significant nonetheless. Certainly the future of both private and government-owned hospitals in North Carolina will be determined by the General Assembly's response to *Aston Park* and *Foster*. Failure to assert some kind of unified policy in

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121. Cf. Paulsen, *supra* note 33, at 103.

122. See text following note 196 *infra* for a discussion of methods of regulation that *Aston Park* does not proscribe. See also *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 34, 199 S.E.2d 641, 654 (1973).

123. Compare *In re Aston Park Hosp., Inc.*, 282 N.C. 542, 549, 193 S.E.2d 729, 734 (1973), with *Foster v. Medical Care Comm'n*, 283 N.C. 110, 127, 195 S.E.2d 517, 528 (1973). "It has not been made to appear that progress has made any substantial change in the relation between those engaged in the occupation under consideration and those whom they serve that would require a reappraisal of the Constitution." *State v. Harris*, 216 N.C. 746, 762, 6 S.E.2d 854, 865 (1941).

this area, if accompanied by similar inaction in other states, may well precipitate direct federal regulation.<sup>124</sup>

Certificate-of-need legislation is only the tip of the iceberg. Health care delivery is a major social concern and the object of intensive study.<sup>125</sup> A particular urgency informs these studies because the public has begun to regard health care as a basic human right, and partly as a result of that attitude, the cost of health care is skyrocketing.<sup>126</sup> In 1950 the average annual expenditure for hospital care was twenty-four dollars per person. By 1970 the average per person had climbed to 125 dollars, and no end to the ascent is in sight.<sup>127</sup>

The consensus of the commentators is that the present system of health care delivery is inadequate. Proposals for reform range from free-market delivery systems<sup>128</sup> to comprehensive government regulation.<sup>129</sup> All sides assail current government planning and regulation as disjointed and ineffective.

#### A. Certificate-of-Need Law

The certificate-of-need law was a first step toward assertion of state control over hospital development. Its primary purpose was to slow or stop the rise in the high cost of hospitalization, the fastest rising of all medical expenses.<sup>130</sup> The high price of new hospital con-

124. See TENNESSEE LEGISLATIVE COUNCIL, *supra* note 16.

125. Several symposia on health care, representing a variety of disciplines, have been published recently. See, e.g., EMPIRICAL STUDIES IN HEALTH ECONOMICS (H. Klarman ed. 1970); Berki & Heston, eds., *The Nation's Health: Some Issues*, 399 ANNALS 1 (1972); Havighurst, ed., *Health Care* (pts. I-II), 35 LAW & CONTEMP. PROB. 229, 667 (1970). From medical and hospital journals, see, e.g., Cherkasky, *Resources Needed To Meet Effectively Expected Demands for Services*, 42 BULL. N.Y. ACAD. MED. 1089 (1966); Fuchs, *supra* note 93; Halbertsam, *Liberal Thought, Radical Theory and Medical Practice*, 284 N. ENG. J. MED. 1181 (1971); Morrissey, *The Dilemma of Hospitals—Is Public Utility Status the Answer?*, HOSPITAL ADMINISTRATOR, Fall 1971, at 14.

126. Andersen & May, *Factors Associated with the Increasing Cost of Hospital Care*, 399 ANNALS 62, 63 (1972). See also H. KLARMAN, *THE ECONOMICS OF HEALTH* (1964); Lave & Lave, *Medical Care and Its Delivery: An Economic Appraisal*, 35 LAW & CONTEMP. PROB. 252 (1970).

127. Andersen & May, *supra* note 126, at 63.

128. See Havighurst, *supra* note 93.

129. See A. SOMERS, *HOSPITAL REGULATION: THE DILEMMA OF PUBLIC POLICY* (1969); Carr, *Economic Efficiency in the Allocation of Hospital Resources: Central Planning vs. Evolutionary Development*, in EMPIRICAL STUDIES IN HEALTH ECONOMICS 195 (H. Klarman, ed. 1970); Somers, *Only the Hospital Can Do It All—Now*, MOD. HOSP., July 1972, at 95, *provoking response* in letter from R. Watkins, MOD. HOSP., Aug. 1972, at 62.

130. Note, 52 IOWA L. REV., *supra* note 96.

struction is a major factor in this total cost increase.<sup>131</sup> Rising wage levels for hospital staff—currently in short supply<sup>132</sup>—are another significant factor.<sup>133</sup> Also, there is no doubt that the lack of effective planning and control aggravates the composite cost rise. In this field free competition contributes to higher costs—not lower ones.<sup>134</sup>

1. *Manpower.* For example, the shortage of trained manpower—both doctors and supportive staff—in an unrestrained labor market causes prices to rise. Manpower is in dramatically short supply and although the shortage has been countered with a concerted response from the North Carolina General Assembly,<sup>135</sup> for the foreseeable future no relief is expected. Therefore when additional hospitals enter a regional market that already has sufficient bed capacity to serve the community, the demand for personnel increases. This drives up wage levels and, consequently, hospital overhead. This effect is re-enforced by the inefficiency that results from spreading resources too thin. Doctors who have patients in all the hospitals in a city waste time traveling from hospital to hospital. In addition, the available technical skills may be spread unevenly among the hospitals—some hospitals are rich in one category of technician and poor in another, while other hospitals have offsetting surpluses and shortages. The to-

131. Andersen & May, *supra* note 126, at 72 & n.8.

132. Carlson, *Health Manpower Licensing and Emerging Institutional Responsibility for the Quality of Care*, 35 LAW & CONTEMP. PROB. 849, 855-56 & n.22 (1970).

133. Anderson & May, *supra* note 126, at 68, 70-71. Andersen and May suggest that while rising wage levels contribute to higher hospital costs, the most important factor may be the rising number of employees hospitals are hiring. *Id.* at 68.

134. See Somers, *The Nation's Health: Issues for the Future*, 399 ANNALS 160, 168-170 (1972).

In short, the health care field is one where all forms of price discipline have been lacking. . . . For years, some reformers have sought ways of compelling more competition while others have sought to bring the various segments of the industry under increased public regulation, including the proposal that the hospital should be declared a public utility.

*Id.* at 169. See generally Stevens, *Hospital Market Efficiency: The Anatomy of the Supply Response*, in EMPIRICAL STUDIES IN HEALTH ECONOMICS 229 (H. Klarman ed. 1970).

The court in *Aston Park* admitted that the free competition that results from overturning the certificate-of-need law might not cause prices to drop, but it speculated that competition would improve service and courtesy to patients among hospitals competing for business. 282 N.C. at 549, 193 S.E.2d at 734. The more likely theory is that hospitals will not respond to that sort of competition at all. *But see* text accompanying notes 144-50 *infra*. Discussing antitrust cases, Professor Strong notes that courts ignored "the fact of economic life that the absence of technical monopoly does not guarantee the presence of active competition; the nature, existence and effect of oligopoly was [not understood by the court]." Strong, *supra* note 28, at 436.

135. See Warren & Ratliff, *New Man on the Health Team—The Physician's Assistant in North Carolina*, POPULAR GOVERNMENT, Feb. 1972, at 13 (discussing N.C. GEN. STAT. § 90-18(13) (Supp. 1973) ).

tal manpower resource is thus used inefficiently and, to that extent, wasted.

2. *Capital Investment.* Unused hospital beds drive up costs because certain services must be available regardless of how many beds are in use in a hospital. To the extent that more beds are filled in a particular hospital, the cost of maintaining the necessary services is more fully distributed. Such services can be provided as cheaply for many beds as for a few. The result is that an empty hospital bed costs two-thirds as much to support as does a bed in use.<sup>136</sup> When excess bed capacity exists in a community, the local hospitals obviously carry the unnecessary expense of maintaining more beds which are producing no income.

Another wasteful aspect of unnecessary duplication of capacity is that certain expensive medical equipment may be available in several hospitals when there is only a limited need for it in a community. Such equipment as open heart surgery units and kidney machines are extraordinarily expensive and used relatively infrequently; in some cities, however, several hospitals might maintain identical facilities when one hospital could serve the entire need.<sup>137</sup> Fortunately, this sort of unnecessary duplication generally is limited to those situations in which prestige and rivalry motivate the purchase of unneeded equipment. Even so, there is a potential for similar duplication on a less spectacular scale wherever more hospitals exist than the needs of the community require. Furthermore, the expense of maintaining duplicate capacities for conventional services may deny a smaller community the ability to support a more elaborate facility.

Unnecessary expenses are undoubtedly translated into higher costs for the health-care consumer. Individual hospital bills reflect the total overhead of the hospital not just the expenses actually caused by an individual patient. The unprofitable services offered by a hospital are thus subsidized by patients paying for the routine services.<sup>138</sup>

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136. See Note, 52 IOWA L. REV., *supra* note 96, at 1195.

137. See generally Randal, *Wasteful Duplication in Our Hospitals*, REPORTER, Dec. 15, 1966, at 35-38. Randal reports the spectacular waste resulting from maintenance of unnecessary open heart surgery units which at that time cost 1.5 million dollars to buy and 100,000 dollars per year to maintain.

138. Cf. H. KLARMAN, *ECONOMICS OF HEALTH* 137 (1964); Steinwald & Neuhauer, *The Role of the Proprietary Hospital*, 35 LAW & CONTEMP. PROB. 817, 834 (1970). See generally *New State Ice Co. v. Liebmann*, 285 U.S. 262, 282 (1932) (Brandeis, J., dissenting). "Competition tends to disappear in decreasing cost industries, but where it persists it leads to higher prices and the wasteful utilization of capital and labor." E. CLEMENS, *ECONOMICS AND PUBLIC UTILITIES* 32 (1950).

Duplication of hospital facilities and capacities is not the sort of waste that a society, which is beginning to contemplate the limits of its resources, can afford to countenance. In view of the huge capital investment in hospitals and the correspondingly large public interest in health care, it would be prodigal to leave the success or failure of these ventures to the survival-of-the-fittest ethic of the open market.<sup>139</sup> Rather than wasting limited investment capital constructing unnecessary hospital beds, capital resources and labor should be allocated in the most efficient possible manner. Smaller communities may well have need of elaborate equipment on a one-per-community basis. Investment capital spent on unnecessary hospital beds, for example, might be better spent on expensive, unprofitable, specialized equipment. Investment capital would be directed into areas which will ensure comprehensive medical care for the entire region.

3. *Cream-skimming*. A related problem is suggested by the fact that Aston Park Hospital was a private, for-profit enterprise—a proprietary hospital. A proprietary hospital entering the market to compete with nonprofit hospitals—especially where there is not enough business to go around—is subject to charges of “cream-skimming”:

The essence of the cream-skimming argument is that proprietary hospitals can and do profit by concentrating on providing the most profitable services to the best-paying patients, thereby skimming the cream of the market for acute hospital care and leaving the remainder to non-profit hospitals.<sup>140</sup>

Such hospitals may forego unprofitable services such as emergency rooms or elaborate equipment that cannot pay for itself although these services are normally expected of full service hospitals. Proprietary hospitals may limit their service in various direct and indirect ways to patients whose ailments are easy and profitable to cure and whose ability to pay the bill is certain. The burden for providing a wide range of perhaps unprofitable services to all comers then falls on the nonprofit hospitals—charitable or government-owned—some of whose paying business has been displaced by the interloper.<sup>141</sup> Nothing in

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139. Cf. *Pue v. Hood*, 222 N.C. 310, 313, 22 S.E.2d 896, 899 (1942); Carr, *supra* note 129, at 217.

140. Steinwald & Neuhauser, *supra* note 138, at 832.

141. *Id.* Cream-skimming is possible where “internal subsidization” exists; that is, when an industry subsidizes unprofitable activities by charging more for its profitable services. Railroads, for example, subsidize unprofitable passenger service by charging higher rates for freight transport. Trucking, by concentrating solely on freight, took that business away from the railroads. This was one reason that trucking became a

the record indicates that Aston Park Hospital had such unworthy motives, but in a community in which an excess of bed capacity already exists, the effect of cream-skimming, if it does occur, will be aggravated.

Certificates of need were fashioned to cope with the waste, duplication, and consequent high cost of medical care in areas with excess capacity. The judicially cognizable public interests served by certificate-of-need regulation are therefore not difficult to perceive. The public has an interest in the availability of adequate health care at a reasonable cost.<sup>142</sup> Moreover, that there is a public interest in avoiding waste of resources, and ensuring the availability of needed services in general has traditionally been recognized by the courts.<sup>143</sup>

4. *Criticism of certificate-of-need regulation.* There are significant economic arguments against certificate-of-need laws, however.<sup>144</sup> The *Aston Park* court identified the core of the opposition to such laws in its general discussion of the economic effects of competition.<sup>145</sup> In another context, Professor Havighurst has specifically discussed the effect of restricting competition in the hospital market. He suggests that the health industry—nonprofit or otherwise—is no less motivated by self-interest than other industries<sup>146</sup> and no more immune to the abuses that flow from protecting any private industry from competition.<sup>147</sup> Moreover, he charges that many of the present misallocations of resources are not the result of too much competition but of too little:

One consequence of the predominately nonprofit orientation of the industry has been to free decision makers to maximize just about any value they choose, including in too many cases the gratifica-

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regulated industry—to protect the railroads. Critics of the process argue that if unprofitable services are socially desirable they should be subsidized directly by excise taxes or other forms of support that are not hidden from the public which bears the expense in any event. See C. HAVIGHURST, PUBLIC UTILITY REGULATION FOR HOSPITALS Reprint No. 17 (1973) (published by the American Enterprise Institute for Public Policy Research).

142. See Note, 52 IOWA L. REV., *supra* note 96.

143. See *New State Ice Co. v. Liebmann*, 285 U.S. 262, 282 (1932) (Brandeis, J., dissenting).

144. Since this comment was prepared, an article by Professor Havighurst has appeared. Generally speaking, he is critical of certificate of need laws. See Havighurst, *Regulation of Health Facilities and Services by "Certificate of Need,"* 59 VA. L. REV. 1143 (1973). See also Gottlieb, *supra* note 16, at 51; Havighurst, *Foreword to Health Care: Part II*, 35 LAW & CONTEMP. PROB. 667 (1970); Havighurst, *supra* note 93.

145. 282 N.C. at 549, 193 S.E.2d at 734.

146. Havighurst, *supra* note 93, at 759.

147. *Id.* at 785 n.217.



tion of administrators' empire-building impulses or physicians' convenience and income derivable from utilization of plant purchased with government or charitable funds.<sup>148</sup>

Although competition is hardly calculated to serve the public interest in every instance, at least "decision makers in profit-making enterprises are more closely disciplined . . . by the market . . . than are decision makers in the nonprofit sector, and their decisions are more likely to accord with public needs"<sup>149</sup> Additionally, restrictions on a free market deny the affected industry "entrepreneurial input" and likely will lead to lessened sensitivity to legitimate consumer preference in an industry where rapport and confidence are particularly important.<sup>150</sup> Additional criticisms have been leveled at the bigness and impersonality that might result if certificate-of-need laws are administered to channel growth only to enlargement of existing facilities.<sup>151</sup>

No one denies the need for planning in the *nonprofit* sector,<sup>152</sup> and, significantly, the decision in *Aston Park* may not preclude certificate-of-need regulation for nonprofit hospitals. *Aston Park* Hospital was a for-profit hospital, and while the opinion spoke in terms of the rights of all private hospitals, not distinguishing between proprietary and nonprofit, its reasoning depended in part on the existence of a profit motive. If the court has indeed made a strong commitment to

148. *Id.* at 752.

149. *Id.*

150. *Id.* at 753-54.

151. See generally Halbertsam, *supra* note 125. But see Roemer, *Controlling and Promoting Quality in Medical Care*, 35 LAW & CONTEMP. PROB. 284, 293 (1970).

152. See Havighurst, *Foreword to Health Care: Part II*, 35 LAW & CONTEMP. PROB. 667 (1970); Havighurst, *supra* note 93, at 752.

The North Carolina Medical Care Commission will probably remain in the business of determining whether regional need exists for new hospital construction and issuing certificates of need, *Aston Park* notwithstanding. In October, 1972, the Congress enacted Pub. L. No. 92-603, § 221, — Stat. —. Its purpose is to see that no Medicare funds are spent in support of unnecessary capital expenditures in hospitals. Whether new investment will satisfy a regional need must be determined by a state planning agency at least half of whose members represent consumer interests. Thus the Medical Care Commission or some similar agency will continue to issue certificates of need although a refusal will no longer deny the applicant entry into the hospital business in North Carolina. Many hope that the teeth provided by this control over the federal purse strings will enable the Commission to assert the sort of control over new construction that the certificate-of-need law was originally intended to provide. See Havighurst, *supra* note 93, at 785 n.217; *Court Strikes Down North Carolina Certificate of Need Law*, MOD. HOSP., March 1973, at 50. Public Law 92-603, § 221 may provide precedent for attaching similar limitations to the expenditure of National Health Insurance funds in the event that a National Health Insurance program is enacted by Congress. If that happens a federal certificate-of-need law may, in effect, result, because National Health Insurance will cover a much broader class of patients than does Medicare.

the profit motive as a policy for providing better service, it may be persuaded by arguments that nonprofit institutions will not provide adequate service without the "spur" of regulation.<sup>153</sup>

### B. Utility Regulation of Hospitals

Another option has been suggested for asserting control over hospitals in North Carolina: to go "all the way" and regulate hospitals as public utilities.<sup>154</sup> Whether hospitals should seek public utility status has been a focal point in the debate over reform of the health care delivery system.<sup>155</sup> None of the commentators—pro or con—has suspected that legislatures might lack the power to grant utility status to hospitals. Their only question has been—if it should be done—whether Congress or the states should do it.<sup>156</sup> After *Aston Park*, however, the North Carolina General Assembly must reckon with its supreme court. A single, inscrutable paragraph in that opinion delimits the options of the legislature to further regulate North Carolina hospitals.<sup>157</sup>

1. *Businesses affected with a public interest.* Like occupational licensing, utility regulation is a matter of economic legislation. State legislatures decide whether industries are granted utility status subject to the limits imposed by the federal and state constitutions.<sup>158</sup> Constitutional limits in this area depend on the court's interpretation of the due process clause of the fourteenth amendment and its equivalent in the

153. Compare *Foster v. Medical Care Comm'n*, 283 N.C. 110, 127, 195 S.E.2d 517, 528 (1972), with *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 199 S.E.2d 641 (1973); see text accompanying notes 201-03 *infra*.

154. See Curran, *supra* note 15.

155. See, e.g., C. HAVIGHURST, PUBLIC UTILITY REGULATION FOR HOSPITALS Reprint No. 17 (1973) (published by the American Enterprise Institute For Public Policy Research); A. SOMERS, HOSPITAL REGULATION: THE DILEMMA OF PUBLIC POLICY (1969); Drake, *Public Utility . . . Its Meaning for Hospitals*, TRUSTEE, April 1973, at 1; Edelman, *Public Utility Regulations*, HOSPITALS, Nov. 1, 1970, at 120; Edwards, *Are Hospitals Public Utilities?*, HOSPITALS, Jan. 16, 1965, at 51; Fuchs, *What Kind of System for Health Care?*, 45 BULL. N.Y. ACAD. MED. 281 (1969); Morrissey, *The Dilemma of Hospitals—Is Public Utility Status the Answer?*, HOSPITAL ADMINISTRATION, Fall 1971, at 14; Mott, *Should Hospitals Seek Public Utility Status?*, MOD. HOSP., June 1967, at 93; Priest, *Possible Adoption of Public Utility Concepts in the Health Care Field*, 35 LAW & CONTEMP. PROB. 839 (1970); Starkweather, *What Can Be Learned From Regulation of Other Industries?*, HOSPITAL ADMINISTRATION, Spring 1972, at 65; Ward, *Health Care Regulation*, HOSPITALS, April 1, 1972, at 101.

156. See Priest, *supra* note 155, at 847; Somers, *supra* note 129, at 100; Note, 52 IOWA L. REV., *supra* note 96, at 1200-01.

157. 282 N.C. at 550, 193 S.E.2d at 735.

158. See State *ex rel.* Utilities Comm'n v. Carolina Tel. & Tel. Co., 267 N.C. 257, 268, 148 S.E.2d 100, 109 (1966).

state constitution. For the Supreme Court of the United States, *Nebbia*, of course, was the watershed case.<sup>159</sup> That opinion laid to rest the traditional legal definition of utilities as "businesses affected with a public interest":

"[A]ffected with a public interest" is the equivalent of "subject to the exercise of the police power" . . . .

It is clear that there is no closed class or category of businesses affected with a public interest, and the function of the courts in the application of the Fifth and Fourteenth Amendments is to determine in each case whether circumstances vindicate the challenged regulation as a reasonable exertion of governmental authority or condemn it as arbitrary and discriminatory. . . .

So far as the requirement of due process is concerned . . . a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adopted to its purpose. The courts are without authority either to declare such policy, or, when it is declared by the legislature, to override it. If the laws passed are seen to have a reasonable relation to a proper legislative purpose, and are neither arbitrary nor discriminatory, the requirements of due process are satisfied, and judicial determination to that effect renders a court *functus officio*.<sup>160</sup>

As the Court of Appeals for the Ninth Circuit has observed, "[W]hile *Nebbia* involved price regulation, the rationale there adopted by the Court is equally applicable with regard to all economic regulation."<sup>161</sup> But certain state courts still apply the "affected with public interest" test to determine whether utility-like regulation may be constitutionally imposed on industries chosen by the legislature.<sup>162</sup> Generally those courts take their precedent from pre-*Nebbia* Supreme Court decisions.<sup>163</sup> As *Nebbia* pointed out, the different tests are misleading. These tests can be reduced to the same subjective determination: whether the regulation proposed bears a sufficient relation to the public interest in the mind of the court. Although the result may

159. On its facts *Nebbia* involved rate regulation in the milk industry in New York.

160. *Nebbia v. New York*, 291 U.S. 501, 533, 536-37 (1934).

161. *Boylan v. United States*, 310 F.2d 493, 497 (9th Cir. 1962), *cert. denied*, 372 U.S. 935 (1963).

162. 310 F.2d at 498 & n.7, *citing* *Hertz Corp. v. Heltzel*, 217 Ore. 205, 341 P.2d 1063 (1959); *Hertz Drivurselb Stations, Inc. v. Siggins*, 359 Pa. 25, 58 A.2d 464 (1948); *Brinks Express Co. v. Public Serv. Comm'n*, 117 Pa. Super. 268, 178 A. 346 (1935).

163. For a discussion of the cases generally cited, see *Davies Warehouse Co. v. Brown*, 137 F.2d 201 (Emer. Ct. App. 1943) (Vinson, C.J., dissenting), *rev'd*, 321 U.S. 144 (1944); *Strong*, *supra* note 28.

be guided by precedents, the court's view of its proper role in the review of economic legislation ultimately determines the outcome on such issues.

The Nebraska Supreme Court in *Boomer v. Olsen*<sup>164</sup> refused to follow the United States Supreme Court and set aside under the *state* constitution a price-fixing statute which the Supreme Court had held to be sound under the *federal* constitution only two years before.<sup>165</sup> After arguing that human judgments are inadequate replacements for the market forces of supply and demand in matters of allocating economic resources, the Nebraska court announced that it would not cease to re-view legislation substantively:

While it is true that the supreme court of the United States has receded from this position in the later cases in interpreting the provisions of the federal Constitution, this court has consistently adhered to the doctrine, *except in a business in which the owner by devoting it to a public use, in effect, grants the public an interest in the use and subjects himself to public regulation to the extent of that interest.* Included in the exception are railroads, bus lines, street car lines, and *similar businesses in which the extent of the public interest is such as to require protection from duplication and competition, and a fixing of rates and charges as a matter growing out of and reciprocal thereto.*<sup>166</sup>

However, there is no fixed formula—no set of preconditions—under which an industry qualifies for utility status. Historically few business enterprises become regulated as utilities overnight.<sup>167</sup> Utilities are identified *legally* not so much by inherent characteristics as by the scheme of privileges and obligations later granted and imposed on them by statute.<sup>168</sup>

Typically, public utilities are granted a statutory monopoly. Would-be competitors are denied entry into the business, or they are conditionally excluded subject to winning a certificate of convenience and necessity—the substantial equivalent of a certificate of need.<sup>169</sup>

164. 143 Neb. 579, 10 N.W.2d 507 (1943).

165. *Olsen v. Nebraska*, 313 U.S. 236 (1941).

166. 143 Neb. at 586-87, 10 N.W.2d at 511 (emphasis added).

167. *Cf. Davies Warehouse Co. v. Brown*, 137 F.2d 201 (Emer. Ct. App. 1943) (Vinson, C.J., dissenting) *rev'd*, 321 U.S. 144 (1944); E. CLEMENS, *ECONOMICS AND PUBLIC UTILITIES* 12-34 (1950); C. PHILLIPS, *THE ECONOMICS OF REGULATION* 19-84 (1965).

168. *See, e.g., State ex rel. Utilities Comm'n v. New Hope Road Water Co.*, 248 N.C. 27, 30, 102 S.E.2d 377, 379 (1958).

169. *See State ex rel. Utilities Comm'n v. Carolina Tel. & Tel. Co.*, 267 N.C. 257, 270, 148 S.E.2d 100, 110 (1966); *cf. State ex rel. Utilities Comm'n v. Story*, 241 N.C. 103, 106, 84 S.E.2d 386, 388 (1954). *See generally* *New State Ice Co. v. Liebmann*,

The privileges of utility status—monopoly and often the power of eminent domain—are considered by courts such as Nebraska's to be *quid pro quo* for the statutory obligations, such as rate controls, that are enforced by a special governmental agency set up for that purpose.<sup>170</sup>

To say how utilities are usually regulated, however, does not say whether a given industry may be so regulated. The pre-*Nebbia* answer, reflected in the quotation from *Boomer v. Olsen*, is that an industry granted utility status must be one that is "devoted to a public use"<sup>171</sup> or "affected with a public interest."<sup>172</sup> These are different ways of denoting the high degree of public interest which justifies extensive regulation. Generally, two identifiable features—apart from the privileges and duties created by statute—seem to characterize industries that may be extensively regulated. First, the product or ser-

285 U.S. 262, 281-82 (1932) (Brandeis, J., dissenting); *Boylan v. United States*, 310 F.2d 493 (9th Cir. 1962); N.C. GEN. STAT. § 40-53 (1966); *id.* § 53-4 (Supp. 1973); *id.* § 62-110 (1965); *id.* § 157-28 (1972).

170. Generally the obligations include: (1) a utility must serve all comers; (2) it must render adequate service; (3) the service must be provided at reasonable rates; and (4) the public must be served without discrimination. See N.C. GEN. STAT. § 62-2 (1965). This structure is only typical, however. Regulation of some industries includes less than all these features—or different regulatory devices.

Dealing primarily with pre-*Nebbia* cases, Judge Vinson assembled the following synthesis to show the attributes and obligations that characterize a "utility."

If a business is (1) affected with a public interest, and (2) bears an intimate connection with the processes of transportation and distribution, and (3) is under an obligation to afford its facilities to the public generally, upon demand, at fair and nondiscriminatory rates, and (4) enjoys, in a large measure an independence and freedom from business competition brought about either (a) by its acquirement of a monopolistic status, or (b) by the grant of a franchise or certificate from the State placing it in this position, it is for the purpose of the Price Control Act . . . a public utility. . . .

The formula is a limited one. It is designed only to provide [a] . . . test or standard by which one may affirmatively determine that a particular business is a public utility. I do not wish to be misunderstood as indicating that a business possessed of or operating under less than the total of these features may not be considered a public utility.

[I]n many States there is an absence of various controls over certain public utilities. Delaware, for example, exercises no rate control whatever. This, however, and other instances of non regulation, is a matter of local policy, and does not represent a want of power.

*Davies Warehouse Co. v. Brown*, 137 F.2d 201, 217 (Emer. Ct. App. 1943) (Vinson, C.J., dissenting), *rev'd*, 321 U.S. 144 (1944).

171. See, e.g., *State ex rel. Utilities Comm'n v. Carolina Tel. & Tel. Co.*, 267 N.C. 257, 268, 148 S.E.2d 100, 109 (1966); *In re Southern Pub. Util. Co.*, 179 N.C. 151, 101 S.E. 619 (1919); *Efland v. Southern Ry. Co.*, 146 N.C. 135, 59 S.E. 355 (1907); *Corporation Comm'n v. Seaboard Airline R.R.*, 140 N.C. 239, 52 S.E. 941 (1905).

172. For a discussion of the cases which established the meaning of these terms see *Davies Warehouse Co. v. Brown*, 137 F.2d 201, 211 (Emer. Ct. App. 1943) (Vinson, C.J., dissenting), *rev'd*, 321 U.S. 144 (1944). *Wolff Packing Co. v. Kansas Ct. of Indus. Relations*, 262 U.S. 522 (1923) and *Munn v. Illinois*, 94 U.S. 113 (1877) are cases which turned on those issues.

vice provided by a prospective utility is centrally important—a necessity—to the social and economic life of the community.<sup>173</sup> Secondly, an industry granted utility status should be one that, if unregulated, would either develop into a monopoly or produce ruinous competition. Either result might jeopardize the availability of a product or service to the public at reasonable cost and threaten to cause needless duplication of facilities.<sup>174</sup> Most often these industries require a large capital investment amounting to a major commitment of a community's resources. When these conditions exist, the waste of resources or the failure to provide adequate services would have substantial social and economic consequences. Herein lies the high degree of public interest that justifies utility regulation.

2. *North Carolina case law.* The North Carolina Supreme Court would probably approach the utility question along the conservative lines of the Nebraska court in *Boomer v. Olsen*. In contrast to the United States Supreme Court, the North Carolina Supreme Court will inquire whether the public interest requires protection from duplication and competition and whether—reciprocal thereto—rate controls are provided. The court's traditional reluctance to grant protection from competition has been discussed. Its prior decisions on rate regulation<sup>175</sup> and similar restraints on freedom of contract<sup>176</sup> have been less restrictive. Nonetheless, in the recent past the North Carolina Supreme Court has construed price-fixing regulation narrowly,<sup>177</sup> and it has shown a marked preference for free price competition unless the unavoidable alternative is private monopoly:

Our economic system is built upon the theory that this is a desirable spur to better service and lower cost to the consumer. The results achieved through long adherence to this system indicate it has merit exceeding that of a system controlled by either a private monopoly or a governmental administrator.<sup>178</sup>

Dicta in recent utilities cases also indicate that the supreme court views utility status as a matter of reciprocal privileges and duties, granted and imposed only on industries which have a particularly close relation to the public interest:

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173. See *Davies Warehouse Co. v. Brown*, 137 F.2d 201, 216 (Emer. Ct. App. 1943) (Vinson, C.J., dissenting), *rev'd*, 321 U.S. 144 (1944); E. CLEMENS, *supra* note 167, at 25.

174. See authorities cited note 167 *supra*.

175. See *Ely Lilly & Co. v. Saunders*, 216 N.C. 163, 4 S.E.2d 528 (1939).

176. See *Morris v. Holshouser*, 220 N.C. 293, 17 S.E.2d 115 (1941).

177. *State ex rel. Milk Comm'n v. National Food Stores, Inc.*, 270 N.C. 323, 154 S.E.2d 548 (1967).

178. *Id.* at 333-34, 154 S.E.2d at 556.

The reason for strict regulation of public utilities is that they are either monopolies by nature or given the security of monopolistic authority for better service to the public. The public is best served in many circumstances where destructive competition has been removed and the utility is a regulated monopoly. "Whether there shall be competition in any given field and to what extent is largely a matter of policy committed to the sound judgment and discretion of the Commission."<sup>179</sup>

In return for the franchise, the utility gives up its right to make private rate contracts with its customers, and submits to the regulation of its rates.<sup>180</sup>

These pronouncements were made, however, in the context of the regulation of industries traditionally considered to be devoted to a "public use."

On the other hand, banking is an industry which is regulated on nearly the same terms as utilities, yet in upholding legislative regulation of banks, the North Carolina Supreme Court made no mention of any *necessary* reciprocity between price and quality controls and the quasi-monopoly status granted to banks. The court simply decided that the public interest justified the regulation:

While a banking institution is a private enterprise every depositor is, in a sense, an investor. Its stability and trustworthiness vitally affects the economic and business life of the community it serves and its solvency is a matter of public concern affecting the general welfare of the State.<sup>181</sup>

3. *Hospitals affected with a public interest.* Before *Aston Park* was decided, plausible arguments could have been advanced to the effect that—even given the North Carolina Supreme Court's probably conservative criteria for justifying utility regulation—utility regulation of hospitals in North Carolina was constitutional. The policy arguments are much the same as those made in support of the certificate-of-need law. The basic political facts are the same: adequate medical care is now considered a necessity of life and "a basic human right," and rising hospital costs threaten to deny adequate hospital care to all but the rich.

Not only is hospital care a necessity, but when the public is not protected from unregulated competition, the hospital industry has both

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179. *State ex rel. Utilities Comm'n v. Carolina Coach Co.*, 260 N.C. 43, 51, 132 S.E.2d 249, 254 (1963).

180. *State ex rel. Utilities Comm'n v. Piedmont Natural Gas Co.*, 254 N.C. 536, 548, 119 S.E.2d 469, 477 (1961).

181. *Pue v. Hood*, 222 N.C. 310, 313, 22 S.E.2d 896, 899 (1942).

the characteristics of monopoly and destructive competition. The starting point for the reformer's arguments is that allocation of medical care to the public should not be made on the basis of wealth.<sup>182</sup> Aside from the inequity involved, ordinary market conditions are not suited to determine the delivery of hospital care for a number of reasons. First, consumers of medical care stand in a different relation to the provider than do consumers in other industries. In effect, medical patients have no meaningful choice among suppliers, and an arm's length relationship cannot and should not often exist. In areas where a choice among several hospitals may be made, the consumer will not have the necessary background to make an intelligent choice about which hospital is best for the money or best suited to his needs. Hospitals are seldom used by the average person, and when they are used, decisions are often made under conditions of emotional stress. In practice the choice of a hospital is often left entirely to the attending physician.<sup>183</sup> In effect, the consumer has little free choice at all and the conditions on which he purchases hospital services are more like the conditions under which one deals with a monopolistic supplier of services than any sort of open market purchase. These monopoly conditions are reinforced in the many small communities in which only one hospital supplies the entire market and in situations where the patient requires the services of specialists or special equipment. For these reasons individual consumers are particularly vulnerable to the desires of the medical and hospital establishment—not always benevolent<sup>184</sup>—and they should be protected against high prices and unfair practices by government supervision and regulation.

While the public needs protection against the monopoly aspect of hospitals, at the same time protection is required against the wasteful competition that exists where hospital bed capacity is in excess of local needs. Furthermore, since so large a proportion of the hospital industry is not operated for profit,<sup>185</sup> normal profit motives do not operate to hold down costs within the hospitals themselves.<sup>186</sup> Hospitalization insurance and government health programs contribute to the problem by

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182. See Fuchs, *supra* note 93.

183. See Priest, *supra* note 155, at 840.

184. See A. SOMERS, *supra* note 155, at 119; Havighurst, *supra* note 146; Fuchs, *supra* note 93.

185. Steinwald & Neuhauser, *supra* note 138, at 817. In 1968 only six per cent of nonfederal, short-term general and other special hospital beds were in proprietary hospitals.

186. A. SOMERS, *supra* note 155, at 203; Somers, *supra* note 134, at 169.



providing for payment for hospital services on the basis of the hospital's costs. This is aggravated by the fact that the demand for hospital care is fixed—it cannot decline much without a decline in population. People who stay away from hospitals because of high costs may only cause higher bills for themselves in the long run by failing properly to treat their maladies. Costs can only rise because there are no economic factors in the market as it is presently structured that will force them down and because planning and control on a voluntary basis is fragmented and ineffective.<sup>187</sup> The combination of these factors<sup>188</sup>—the vulnerable position of the individual consumer and the failure of the present system to provide adequate care at reasonable prices—in an industry so closely related to the public interest are strong arguments for justifying utility regulation of hospitals.<sup>189</sup>

4. *Implications of Aston Park.* But these arguments must be viewed in light of the *Aston Park* decision. There the court distinguished certificate-of-need regulation from utility regulation because there was no reciprocity between the monopoly status created by cer-

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187. See Edwards, *supra* note 155; Somers, *supra* note 134; Steinwald & Neuhauser, *supra* note 138, at 834.

188. A further argument for utility regulation is that without utility status non-profit hospitals find it increasingly difficult to obtain financing for new construction. After *Foster v. Medical Care Comm'n* this will be more of a problem in North Carolina. House Bill 2137, introduced March 25, 1974, in the North Carolina General Assembly, appears to be a legislative response to the problem in behalf of one hospital. The bill would authorize Rex Hospital, a private charitable institution, to issue bonds for the costs of new construction. As well, it would authorize the trustees of the hospital to convey its facilities to the state, county, city or another political subdivision. Should such a conveyance take place, Rex apparently would no longer be hindered by the *Foster* limitations on revenue-bond financing, since *Foster* applies only to private institutions.

189. Policy-makers should not overlook the strong arguments against traditional methods of regulation, however. In the years since the 1930's many legal scholars have become opponents of such regulation while representatives of private industry have begun to support more regulation. See R. POSNER, *supra* note 32, at 138-54; POSNER, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548 (1969); Symposium—*Return of the Invisible Hand: The New View of Economic Regulation*, 9 COLUM. J.L. & SOC. PROB. 1 (1972). See also Jones, *Regulation Under Fire: Consumers, the Environment, the Economy, and the Impact of Change*, 8 COLUM. J.L. & SOC. PROB. 35 (1971). Professor Havighurst has leveled new criticisms at proposals for regulating the hospital industry in two recent publications: C. HAVIGHURST, *supra* note 155; Havighurst, *Regulation of Health Facilities and Services by "Certificate of Need,"* 59 VA. L. REV. 1143 (1973). Utility regulation, he says, is inherently protectionist and inefficient and, as well, provides poorly for allocation of resources. Such tendencies will be particularly aggravated if a utility scheme is superimposed on the hospital industry. To make low cost medical care available to all yet stimulate efficient hospital operations while preventing overinvestment, he advocates a new form of government participation in the health care market. The essential elements of his program are a liberal National Health Insurance Plan and government supported health maintenance organizations.

tificates of need and protection (rate control) for the public against the consequences of the *statutory* monopoly.<sup>190</sup> The apparent implication was that if price controls had been provided, certificates of need might have proved acceptable to the court. This is not so clear, however, in view of the broader holding of the case.

The court in *Aston Park* failed to find sufficient public interest to justify the certificate-of-need law based on (1) the argument that that hospitals are like other industries as far as competition's effects are concerned; (2) the argument that to restrict entry into a business requires a greater quantum of public interest than do other regulatory measures. To convert certificate-of-need regulation into utility regulation would amount to adding protective measures such as rate controls to the statutory monopoly feature of the certificate-of-need law. On the face of it, to add more regulation—rate controls<sup>191</sup>—to an already objectionable regulatory program might be expected only to increase the court's objections. For a free-enterprise-minded court, however, there is economic justification for the position that market entry restrictions plus rate controls are less objectionable than market-entry restrictions alone. According to *laissez-faire* theory, by restricting entry into the hospital industry certificate-of-need laws distort the competitive market.<sup>192</sup> Rate controls serve to reestablish the competitive balance by preventing the noncompetitive prices that result from entry limitations. Thus on "free competition" grounds rate controls are a curative measure for entry restrictions.<sup>193</sup>

Even so, price regulation is not favored by the present court,<sup>194</sup> and in *Aston Park* the court rejected arguments that hospitals are different from other businesses as far as competition's effects are concerned.<sup>195</sup> Furthermore, the court has found that there is insufficient public interest in hospitals to justify excluding new entrants into the market. While price regulation would add the element of protection for the public to the legislative program, it could not add to the quantum of public interest in hospitals, and it would not soften the impact

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190. See note 87 *supra*.

191. See Strong, *supra* note 28, at 428 & n.21.

192. The "theory" clearly fails to fit the facts here because even unregulated the hospital industry is hardly competitive, and entry into the market is restricted by the high initial investment necessary to open a new hospital. Thus the threat of free competition does not operate well to keep prices reasonable.

193. See Strong, *supra* note 28, at 432; cf. *Tyson & Bro. v. Banton*, 273 U.S. 418, 451-52 (1927) (Stone, J., dissenting).

194. See text accompanying note 178 *supra*.

195. See text accompanying note 92 *supra*.

on a newcomer excluded from the hospital industry. Thus conventional utility regulation, including both price controls and certificates of convenience and necessity, appears to have been foreclosed by the decision in *Aston Park*. Those arguing for utility regulation, however, may respond on the basis of the economic analysis above that price regulation added to entry restrictions poses less of a threat to the public interest in low cost medical care than does entry regulation alone; therefore the quantum of public interest in hospitals acknowledged in *Aston Park* is sufficient to justify utility regulation although insufficient to support certificate-of-need regulation.

5. *Other methods of regulation.* In any event, other methods of regulation have not been foreclosed. Price controls without restriction of entry<sup>196</sup> are likely to be acceptable to the court, and extensive regulation directed only at *non-profit* hospitals may be possible. Although the court apparently does not favor price regulation, it noted in *Aston Park* that price regulation requires less public interest to justify it than do certificates of need.<sup>197</sup> In this instance the implication is unavoidable—rate controls for hospitals in North Carolina will meet with no objection from the court. Various types of rate review legislation have already been enacted in a number of states,<sup>198</sup> and several industries in North Carolina are subject to strict price and quality controls without the corresponding monopoly status found in "straight" utility regulation.<sup>199</sup> Furthermore, rate controls can be used to accomplish some of the control over hospital construction sought in the certificate-of-need regulation. In the case of other industries, rate controls may prevent newcomers from unseating established providers by outlawing price undercutting.<sup>200</sup> That same direct effect cannot be ex-

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196. See *Milk Comm'n v. Galloway*, 249 N.C. 658, 107 S.E.2d 631 (1959); N.C. GEN. STAT. § 106-266.8 (10) (Supp. 1973); *id.* § 106-266.9 (Supp. 1973) (milk distribution).

197. See text accompanying note 88 *supra*.

198. See, e.g., CALIF. HEALTH & SAFETY CODE §§ 440-42.12 (West Supp. 1973); MD. ANN. CODE art. 43 §§ 568H-68Y (Supp. 1973); MASS. ANN. LAWS ch. 7, §§ 30K-30P (1973); N.J. STAT. ANN. §§ 17:48-6 to -9 (1963); N.Y. PUB. HEALTH LAW § 2807 (McKinney 1971); N.Y. INS. LAW § 254 (McKinney Supp. 1973); PA. STAT. ANN. tit. 40 § 1560 (Supp. 1973).

On January 28, 1974, Senate Bill 1013 and an identical bill, House Bill 1451, were introduced in the North Carolina General Assembly. The bills propose to establish an agency within the Department of Human Resources that will monitor and disseminate information relating to costs of services provided by health care institutions. The bills further propose that the agency will *recommend* rates to be charged for these services.

199. See note 196 *supra*.

200. See generally *State ex rel. Milk Comm'n v. National Food Stores, Inc.*, 270 N.C. 323, 154 S.E.2d 548 (1967).

pected in the hospital industry, though, since consumers seldom make price comparisons in the first place. But a combination of minimum rates and quality controls can be devised for the hospital industry that will discourage for-profit hospitals from undertaking unneeded construction in any region by limiting the opportunity for cream-skimming.

In addition to rate and quality controls for the entire industry, the legislature may also have the latitude to regulate nonprofit hospitals extensively if it does not affect the proprietary ones. As previously noted,<sup>201</sup> the rationale of the *Aston Park* case depended in large part on the existence of profit motives for the validity of the free competition argument. Although *Aston Park Hospital* itself was a proprietary corporation, the overwhelming majority of hospitals are nonprofit institutions<sup>202</sup> to whose operations profit makes less difference.<sup>203</sup>

Furthermore, there is a greater quantum of public interest in nonprofit—at least in charitable and government-owned—hospitals than in proprietary ones. Charitable hospitals have long been distinguished from for-profit hospitals for property tax exemption purposes.<sup>204</sup> Also, subsequent to the failure to find “public purpose” in nonprofit hospitals in *Foster v. Medical Care Commission*, the court suggested in a short dictum by Justice Sharp that if the state asserts comprehensive control—particularly over rates—over *charitable* hospitals, the supreme court may be willing to countenance concurrent grants of privileges and even financial support in view of the sizable public benefit derived from the operation of charitable hospitals.<sup>205</sup> So, while *Aston Park* probably foreclosed excluding entry of privately financed, for-profit hospitals into the industry, the legislature may still have the authority to control new construction in the charitable, and perhaps, the nonprofit sector.

This dovetails rather neatly with the proposals of one of the most articulate commentators on hospital reform. Professor Somers has called for a hands-off policy on for-profit hospitals to be accompanied

201. See text accompanying notes 152-53 *supra*.

202. See note 185 *supra*.

203. See Rothenberg, *supra* note 102, at 225; Stevens, *supra* note 134, at 231.

204. See *Piedmont Memorial Hosp., Inc. v. Guilford County*, 218 N.C. 673, 112 S.E.2d 265 (1940); *Salisbury Hosp., Inc. v. Rowan County*, 205 N.C. 8, 169 S.E. 805 (1933). See also H. LEWIS, *PROPERTY TAX EXEMPTIONS AND CLASSIFICATIONS* 196-97 (1970).

205. *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 34, 199 S.E.2d 641, 654 (1973): “[I]mplicit in the *Foster* decision is recognition of the fact that the Medical Care Commission would have had no control over a private hospital and no authority to regulate its rates in the public interest.”

by a program of state-granted benefits for nonprofit "franchised" hospitals.<sup>206</sup> She maintains that conventional utility regulation—monopoly plus rate controls—is too narrow in concept to respond to the heavy demands placed on hospitals for delivery of health care.<sup>207</sup> She has proposed instead a program that would preserve some measures of competition and free choice yet curb the fragmentation and duplication of facilities that results from unbridled competition. Competition, she argues, should "take place [but] within the context of some form of effective regional planning and regulation."<sup>208</sup> A system of benefits for the non-profit hospitals such as tax exemptions and state financing arrangements will assure the government that adequate health care can be made available to all at reasonable costs.<sup>209</sup> Professor Somers' proposals are attractive because they can be effected without drastic reorganization of existing institutions.

#### IV. CONCLUSION

*Aston Park* and *Foster* were dramatic decisions, because through them the supreme court set aside the entire legislative response to a recognizable social problem. *Aston Park* demonstrates that the North Carolina Supreme Court is fundamentally committed to free enterprise economics. But free enterprise as an economic theory is dependent on the profit motive for its animating spark. Where profit-seeking among competing enterprises is not a factor, the supreme court's policies should have no application.

An important characteristic of the hospital industry is the overwhelming number of nonprofit providers. The General Assembly can look beyond the court's two decisions by focusing on this nonprofit sector. It can enact planning and control measures directed only at the charitable and government-owned hospitals that will begin to slow the rise of hospitalization costs without violating the precepts of *Aston Park*. Especially if rate controls and other devices calculated to protect the public are provided, the legislature may still be able to establish a wide range of privileges for charitable and government-owned hospitals without running afoul of *Foster*.<sup>210</sup>

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206. Somers, *Only The Hospital Can Do It All—Now*, MOD. HOSP. July 1972, at 95, 98.

207. Somers, *Regulation of Hospitals*, 400 ANNALS 69, 79 (1972).

208. *Id.* at 80.

209. *Id.*

210. See *Stanley v. Department of Conservation & Dev.*, 284 N.C. 15, 109 S.E.2d 641 (1973).

Before any new scheme of hospital regulation is undertaken, however, the General Assembly should act to demonstrate to the court its non-protectionist motives by establishing a legislative research commission to study the matter fully and to consider explicitly the wide range of proposals for reform in this area.<sup>211</sup>

Clearly some government action is necessary—whether it be to create a truly competitive market with subsidized consumers<sup>212</sup> or to create the next great regulated industry. A failure to respond to “the health care crisis” by the states could stimulate federal regulation—a remedy few commentators favor.

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211. *See* note 106 *supra*.

212. *See* notes 93 & 189 *supra*.

