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The Contract Clause: A Basis For Limited Judicial Review of State Economic Regulation

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I. INTRODUCTION

In 1977 and 1978 the Supreme Court of the United States

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brought the contract clause[1] out of retirement[2] to strike down two state statutes.[3] A majority of the Court[4] apparently believed that the contract clause, once a mighty warrior against state interference with property rights,[5] had potential as a source of intermediate judicial review. In *United States Trust Co. v. New Jersey*,[6] the Court refitted the clause with a right fist of iron for use against a state's impairment of its own obligations; and in *Allied Structural Steel Co. v. Spannaus*,[7] the Court made the clause an extremely versatile soldier, giving it a left fist of aluminum for use against interference with private contracts. It appeared that the clause would stand alongside the taking clause[8] as a rear guard protecting against certain types of retroactive economic legislation—a limited, and arguably arbitrary, response to lingering doubts about the wisdom of the disavowal of judicial review under the due process and equal protection clauses of the fourteenth amendment.[9]

The Court's enchantment appears, however, to have been short-lived.[10] In two unanimous[11] decisions during 1983, the Court

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1. "No state shall . . . pass any . . . law impairing the obligation of contracts." U.S. CONST. art. I, § 10, cl. 1.

2. For views as to the importance of the clause before 1977, see E. CORWIN, THE CONSTITUTION AND WHAT IT MEANS TODAY 102-05 (H. Chase & C. Ducat rev. ed. 1973); L. TRIBE, AMERICAN CONSTITUTIONAL LAW 465-73 (1978); Schwartz, *Old Wine in Old Bottles? The Renaissance of the Contract Clause*, 1979 SUP. CT. REV. 95 (1979).

3. *See* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978); United States Trust Co. v. New Jersey, 431 U.S. 1 (1977).

4. *Spannaus* was a five-to-three plurality decision; however, Justice Blackmun, a nonparticipator in *Spannaus*, wrote the majority opinion in *United States Trust*.

5. For detailed analysis of the Supreme Court's consideration of the contract clause during the 19th and early 20th centuries, see 2 B. SCHWARTZ, A COMMENTARY ON THE CONSTITUTION OF THE UNITED STATES: THE RIGHTS OF PROPERTY ch. 14 (1965); B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION (1938); Hale, *The Supreme Court and the Contract Clause*, 57 HARV. L. REV. 512, 621, 852 (1944).

6. 431 U.S. 1 (1977).

7. 438 U.S. 234 (1978).

8. "[N]or shall private property be taken for public use, without just compensation." U.S. CONST. amend. V. The taking clause is incorporated into the due process clause of the fourteenth amendment. Webb's Fabulous Pharmacies v. Beckwith, 449 U.S. 155, 160 (1980); Chicago B. & Q.R.R. v. Chicago, 166 U.S. 226, 239 (1897).

9. The number of contract clause cases in which parties sought Supreme Court review indicates the increased importance of the contract clause after *United States Trust* and *Spannaus*. From the appointment of Justices Powell and Rehnquist, which solidified the "Burger Court" in January of 1972, until April 27, 1977, when the Court decided *United States Trust*, there were 22 denials of certiorari and dismissals of appeal that included contract clause issues. From the decision in *United States Trust* until last term's decision in Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983), there were 43 denials of certiorari and dismissals of appeal that presented contract clause questions.

10. The doctrinal leaps taken in *United States Trust* and *Spannaus*, the atypical nature of the statutes involved, and Justice Brennan's strident dissents all foreshadowed a

all but nullified the contract clause. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*[12] and *Exxon Corp. v. Eagerton*[13] indicate the Court's retreat from the broader implications of *United States Trust* and *Spannaus* and, perhaps, its return to "classical" contract clause analysis. Neither case involved public contracts, but the Court's approach suggests that the clause may be at issue only in municipal finance wars.[14]

This Article is an inquiry into whether the clause is worth saving. The inquiry is two-pronged. One prong is whether the clause can be given a sound doctrinal basis that will provide a high degree of reliability in constitutional decision-making. The other prong is whether a viable contract clause is consistent with post-Depression views regarding judicial interference with economic legislation.[15] This Article argues that the clause can be put on a strong, although undeniably complex, doctrinal foundation and that a viable contract clause is not only consistent with current standards of review under the due process and equal protection clauses, but could reduce the tension that the nonreview policy generates among members of the Court.[16]

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limiting decision. Professor Powe concluded that Justice Stewart's opinion in *Spannaus* was so poorly reasoned that it would probably not have any constitutional significance. Powe, *Populist Fiscal Restraints and the Contract Clause*, 65 IOWA L. REV. 963, 971 (1980).

11. Justice Powell wrote a concurring opinion in Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983) (Powell, J., concurring in part).

12. 459 U.S. 400 (1983). Though the Court decided a contract clause issue earlier in the term in Texaco v. Short, 454 U.S. 516 (1982), the contract clause claim was disposed of in a paragraph. *See* 454 U.S. at 531. The Court was correct in finding that the alleged impairment—the filing of a notice of claim—was almost trivial in comparison with the drastic consequences of noncompliance.

13. 103 S. Ct. 2296 (1983).

14. Most of the scholarly comment on *United States Trust* relates to its effect on municipal bond issues. *See, e.g.*, Hurst, *Municipal Bonds and the Contract Clause: Looking Beyond* United States Trust Co. v. New Jersey, 5 HASTINGS CONST. L.Q. 25 (1978); Kraft & St. John, *The Contract Clause as Guardian Against Legislative Impairment of Municipal Bondholders' Rights*, 6 SETON HALL L. REV. 48 (1977).

15. *See generally* McCloskey, *Economic Due Process and the Supreme Court: An Exhumation and Reburial*, 1962 SUP. CT. REV. 34 (1962) (characterizing the demise of judicial review of economic legislation as abdication by the Court and arguing for the revival of a limited economic due process doctrine). The primary focus here will be on the first part of the inquiry because the policy and internal consistency of contract clause doctrine have yet to be adequately explained. The second part of the inquiry is dealt with less comprehensively because the general question of the proper scope of judicial review has been so widely debated and because the clause does have a policy basis that distinguishes it from the due process and equal protection clauses. Moreover, the persuasiveness of the conclusions reached with respect to the first prong of our inquiry goes a long way toward justifying a conclusion as to the second prong.

16. The Court's debate over the meaning of the "equal protection rational basis" test

Because most lawyers are not familiar with the contract clause, this Article briefly reviews its history and provides a more detailed discussion of the Burger Court's decisions, before raising the threshold question of what is meant by the "obligation" of a contract. The nature of the contract rights in general and the historical purposes of the clause, demonstrate that the clause should protect only contractual interests that have been "purchased" by investment-backed reliance and that could not have been insulated by a bargained-for contractual clause that shifts the risk of government action. This conclusion is based in large part on the view that the policy underlying the clause is still valid: Contract rights deserve special protection because they are perhaps the one property interest that is most closely related to allocative efficiency and the growth of commerce. They represent resources in transition. In this regard, the contract clause is less similar to the due process clause than it is to the taking and commerce clauses. Like the taking clause, it includes an element of equity—retroactive laws are unfair—and, like the commerce clause, an element of efficiency—interference with commerce by individual states reduces the size of the national economic pie.[17]

After determining the meaning of a contract obligation, the second step in the analysis is the reconciliation of the contract clause with the taking clause. In most cases, legislation that seemingly impairs a contract obligation will also "take" it, entitling the claimant to just compensation. Because a compensation award is an adequate remedy, the contract clause should not be interpreted to invalidate statutes that merely take. Only if a taking clause claim is not available does a statute even arguably "impair" an obligation.

This Article demonstrates that the converse of this last state-

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demonstrates this tension. *See, e.g.*, Logan v. Zimmerman Brush Co., 445 U.S. 422 (1982); United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166 (1980).

17. The terminology used in the last textual sentence is about as close as this Article will get to notions of welfare economics. Although Professors Ackerman, *infra* note 171; Michelman, *infra* note 221; and Sax, *infra* note 206, employ utilitarian concepts in analyzing "taking" issues, the practical problems of measuring either costs or benefits mean that the concepts are of little use to judges or lawyers. Moreover, efficiency considerations, although central to an understanding of economic theory, are of little or no use in specific factual situations. Conclusions about more or less efficient outcomes depend on the existence of the assumptions underlying the economic model being used. Because those assumptions are merely theoretical in nature, any conclusion about efficiency can be made only after an extemely detailed study of the true facts and circumstances that surround a particular case. *See* SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE ch. 2 (2d ed. 1980).

ment is not true—a contract clause claim does not exist simply because a taking clause claim is unavailable. Such a claim exists only if the government deprives a contractor of a remedy or subjects him to an additional obligation for which the parties have not bargained. Although this issue primarily involves a question of contract law rather than constitutional law, the former is worthy of consideration because proper analysis can avoid problematic constitutional issues.

A finding of an impairment of the right to contract does not, however, end our inquiry. A court must still consider the public's interest in overriding the private contract right. This Article considers the proper scope of judicial review—for it is this part of the analysis that raises the ultimate question of constitutionality—and the need for, and the proper elements of, a balancing of public and private interests. This author concludes that the traditional rule permitting any exercise of the police power to override the private or contract clause interest should be replaced with a consideration of (a) the effect of changed circumstances on the public viewpoint and (b) the respect given the private claim in solving the public problem. A court should permit only a statute that responds to changed circumstances and gives due regard to the private interest to override the contract clause prohibition against impairment.

The ultimate conclusion of this analysis is that the contract clause promotes a specific and beneficial national policy and that it can be applied in a way that furthers that policy without unduly interfering with state attempts to deal with changing economic problems. In short, the similarity between traditional contract clause doctrine and substantive due process[18] has led to the premature rejection of a useful constitutional provision.

II. The Rise and Fall of the Marshall Contract Clause

The contract clause was the primary constitutional restraint on state and local regulation of business until the late 19th century because it was the only provision of the Constitution that could be construed as a restriction on state interference with property rights.[19] As the Supreme Court began to apply the due process clause of the fourteenth amendment to economic regulation, the

18. Professor Hale recognized that the clauses were so similar that "the results might be the same if the contract clause were dropped out of the Constitution, and the challenged statutes all judged as reasonable or unreasonable deprivations of property." Hale, *supra* note 5, at 890-91.

19. Schwartz, *supra* note 5, at 268.

importance of the contract clause gradually diminished.[20]

The judicial history of the clause is especially interesting because the Framers of the Constitution apparently intended it to serve the limited purpose of preventing the states from adopting debtor-relief laws.[21] State statutes that delayed maturities, gave debtors the right to make payments in installments and permitted payments in property other than specie were quite common and had the effect of disrupting the growth of commerce.[22] Whether the Framers intended the clause to apply solely to such measures, however, is not clear. The Framers adopted it virtually without discussion and gave it only brief mention in the debates.[23]

The inclusion of the contract clause in section 10 of article I of the Constitution supports both a narrow and a broad interpretation of its meaning. Justice Brennan has argued that the proximity of the clause to provisions preventing the states from emitting bills of credit or requiring anything other than specie as legal tender indicates that the clause was limited to striking down debtor-relief measures.[24] Justice Black, on the other hand, argued that the inclusion of the clause in proximity to the prohibitions on *ex post facto* laws and bills of attainder reflects the strong belief of the Framers that men should not have to act with the risk that the government may change its mind and alter the legal consequences of their past acts.[25] Perhaps because the legislative history of the clause is so ambiguous, the Court's majority has given scant attention to the Framers' intent in the leading modern cases construing the clause.[26] The dissent in these cases, however, has deemed the

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20. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 241 (1978); United States Trust Co. v. New Jersey, 431 U.S. 1, 15 (1977); *see also* SCHWARTZ, *supra* note 5, at 268; WRIGHT, *supra* note 5, at 91-100.

21. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 257 (1978) (Brennan, J., dissenting) (the contract clause should only be applied to debtor-relief laws); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 427-28 (1934). For an alternative position on the Framers' intent in creating the contract clause, see SCHWARTZ, *supra* note 5, at 269-70, and WRIGHT, *supra* note 5, at 15, who suggest that the Framers were interested in establishing essential rights of property.

22. *See* WRIGHT, *supra* note 5, at 4.

23. *Id.* at 8-10; Schwartz, *supra* note 2, at 113-14.

24. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 247 (1978) (Brennan, J., dissenting).

25. El Paso v. Simmons, 379 U.S. 497, 522 (Black, J., dissenting), *reh'g denied*, 380 U.S. 926 (1965).

26. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978); El Paso v. Simmons, 379 U.S. 497, *reh'g denied*, 380 U.S. 926 (1965); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 427 (1934).

Framers' intent to be unequivocal and worthy of discussion.[27]

The importance of the contract clause in our constitutional history is due not to the Framers but to Chief Justice John Marshall. Marshall seized upon the clause as the only means available to the Supreme Court to prevent state interference with property rights.[28] The lack of debate at the Constitutional Convention may show that the Framers unanimously viewed the clause as a fundamental provision of the Constitution, but Marshall extended the clause far beyond what the Framers could have envisioned. Professor Schwartz has concluded that Marshall's holding in *Fletcher v. Peck*[29]—that the contract clause applies to contracts between a state and private citizens[30]—was a "creative act of the first magnitude and one which resulted in a virtual metamorphosis of the organic provision."[31]

Marshall made two other primary contributions to the vitality of the clause. First, he ruled in *Sturges v. Crowninshield* that laws in effect at the time parties enter into a contract become part of the contract and cannot be repealed or amended without impairing its obligation.[32] Secondly, he held in *Trustees of Dartmouth College v. Woodward*[33] that corporate charters are a contract between the corporation and the state. The latter holding has been credited with contributing much to the development of the American economy by freeing the corporate entity from arbitrary state interference, thereby facilitating the accumulation of capital necessary to support economic growth.[34]

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27. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 256-57 (Brennan, J., dissenting); El Paso v. Simmons, 379 U.S. 497, 521-22 n.7 (Brennan, J., dissenting), *reh'g denied*, 380 U.S. 926 (1965); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 454-65 (Sutherland, J., dissenting).

28. SCHWARTZ, *supra* note 5, at 271.

29. 10 U.S. (6 Cranch) 87 (1810).

30. *Id.* at 136-37.

31. SCHWARTZ, *supra* note 5, at 274.

32. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 197-200 (1819). The development of the police power doctrine minimized the importance of this rule. *See infra* text accompanying notes 42-47.

33. 17 U.S. (4 Wheat.) 518 (1819). New Jersey v. Wilson, 11 U.S. (7 Cranch) 164 (1812), often cited as an important Marshall contract clause decision, held that the clause prohibited New Jersey from revoking a tax exemption granted to the plaintiff's predecessor in title. The "rule of strict construction," however, limits this case to its facts. *United States Trust*, 431 U.S. at 51 n.15 (Brennan, J., dissenting) (although *Wilson* has not been overruled, modern cases avoid its holding and reasoning). Marshall himself soon limited the decision by holding that a permanent exemption can never be implied. Providence Bank v. Billings, 29 U.S. (12 Wheat.) 213 (1827); *see also* SCHWARTZ, *supra* note 5, at 299; WRIGHT, *supra* note 5, at 53.

34. SCHWARTZ, *supra* note 5, at 278.

Marshall was not completely successful in extending the contract clause to the extent he desired. In *Ogden v. Saunders*,[35] he was outvoted on the issue of whether the clause prohibited prospective changes in statutes affecting contracts. If Marshall had been successful in convincing one other member of the Court that the state insolvency law at issue in *Ogden* did not apply to contracts entered into after the state legislature adopted the law, the contract clause would have protected not only contracts but also the freedom to contract.[36] This would have eliminated the need for the Court to construe the fourteenth amendment as a protection of the freedom to contract, and the contract clause might have retained its early preeminence.[37]

The maximum scope of the contract clause was established by the time Marshall left the Court. From 1842 until 1890, the Court refined and applied the principles that Marshall had developed to restrict state regulation of corporations—especially railroads, public utilities, and banks.[38] But more importantly, the pendulum began to swing toward restriction of the scope of the clause. The Court held that public contracts must be strictly construed in favor of the state;[39] that the state cannot bargain away its basic powers of sovereignty;[40] and that public contracts are subject to the reserved power of the state to amend and repeal.[41]

The most significant of these limitations is that a state cannot bargain away its police power and that every public and private contract is subject to the proper exercise of that power. The Court did not firmly establish this rule until 1880 when it held in *Stone v. Mississippi*[42] that a state in the exercise of its power to protect the public morals could revoke a charter to operate a lottery. The rationale is deceivingly simple. As Chief Justice Waite explained in *Stone*, the power is an essential attribute of sovereignty, the very purpose for which people form a government.[43] The people themselves cannot bargain away their power to protect the public

35. 25 U.S. (12 Wheat.) 213 (1827).

36. This was the only case in which Marshall was outvoted on a constitutional issue. SCHWARTZ, *supra* note 5, at 272; WRIGHT, *supra* note 5, at 241.

37. SCHWARTZ, *supra* note 5, at 271-72.

38. SCHWARTZ, *supra* note 5, at 267-68; WRIGHT, *supra* note 5, at 62-63.

39. Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 420, 546-47 (1837).

40. Stone v. Mississippi, 101 U.S. 814, 817-18 (1879) (police power); West River Bridge Co. v. Dix, 47 U.S. (6 How.) 507, 532-34 (1848) (eminent domain).

41. Miller v. New York, 82 U.S. (15 Wall.) 478, 488-89 (1873).

42. 101 U.S. 814 (1879).

43. *Id.* at 820.

health, safety, and morals;[44] therefore, a legislature's attempt to do so is obviously without effect because it is the people's servant.[45] The Chief Justice then reasoned that "[t]he contracts which the Constitution protects are those that relate to property rights, not [to] governmental" rights.[46] It is a governmental right to suppress a lottery, and parties to a contract cannot bargain away that right. The charter that the Mississippi Legislature granted to the lottery company was not the equivalent of an irrevocable contractual right to operate the lottery for twenty-five years. Instead, the company had a mere license to operate the lottery until the people or the legislature determined otherwise.[47]

The "police power doctrine" established in *Stone* signalled the end of the significance of the contract clause. Soon the due process clause of the fourteenth amendment eclipsed the clause as the primary restraint on economic regulation.[48] The Court relied primarily upon the police power doctrine to uphold statutes, even though a narrower basis of decision would have been more suitable. For example, *Atlantic Coast Line Railroad v. Goldsboro*[49] involved a claim by a railroad that its franchise to use a street for its tracks prevented the city from regulating the times during which it used the tracks for shifting cars. The Court could have relied upon the rule that it will strictly construe public contracts in favor of the state. Instead, the Court based its decision upholding the ordinance on the police power doctrine, stating that it was settled that the contract clause does not override state police power and that such power cannot be bargained away.[50]

After *Atlantic Coast Line*, a regulation exceeds the legitimate bounds of the police power and therefore violates the contract clause only if it does not in any way "promote the health, comfort, safety, or welfare of the community, or . . . [if] the means em-

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44. This Article uses the shorthand "police power" to describe the government's power to protect the public health, safety, and morals. Whether it is possible to beneficially define the police power more precisely is debatable, but such a definition is not necessary for this discussion. The necessary inquiry is what is the effect of a purported exercise of the power on protected rights.

45. *Stone*, 101 U.S. at 819.

46. *Id.* at 820.

47. *Id.* at 821.

48. *See supra* text accompanying notes 19-20. The Supreme Court decided a surprisingly large number of cases under the contract clause between 1890 and 1934, but they tended to be relatively insignificant applications of past holdings to slightly variant fact patterns. WRIGHT, *supra* note 5, at 95-100.

49. 232 U.S. 548 (1914).

50. *Id.* at 558.

ployed have no real and substantial relation to the avowed or ostensible purpose, or . . . [if] there is wanton or arbitrary interference with private rights."[51]

The vitality of the traditional contract clause doctrine thus waned in the early years of this century, and in 1934 its death knell sounded. In *Home Building & Loan Association v. Blaisdell*,[52] the leading modern case on the contract clause, the Court upheld the constitutionality of a Minnesota mortgage moratorium law. The statute under attack was a Depression measure that permitted a court to extend the time during which a debtor could redeem his mortgaged property from a foreclosure sale if the debtor paid the mortgagee the income or rental value of the property during the interim period.[53] Chief Justice Hughes briefly reviewed the history of the contract clause and summarized the meaning of the clause as follows: "The obligations of a contract are impaired by a law which renders them invalid, or releases or extinguishes them . . . and impairment . . . has been predicated of laws which without destroying contracts derogate from substantial contractual rights."[54]

The Chief Justice stated that the challenged statute basically affected a mortgagee's remedy rather than its rights under the contract, but he refused to base his decision on the right/remedy distinction that the Court had employed so often in previous contract clause cases.[55] Nor did the emergency created by the Depression by itself justify the impairment.[56] Rather, the Chief Justice based his decision on the police power doctrine. After reviewing the police power cases, he stated that the "question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."[57]

The statute at issue in *Blaisdell* was valid under this test. It did not impair the basic obligation of the mortgagor to pay the full amount of his debt; it simply changed the time of payment. The statute was addressed to a broad economic problem that had

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51. *Id.* at 559.

52. 290 U.S. 398 (1934).

53. *Blaisdell*, 290 U.S. at 416-18; *see* Minnesota Mortgage Moratorium Law, ch. 339, 1933 Laws of Minn. 514.

54. *Blaisdell*, 290 U.S. at 431 (footnotes omitted).

55. *Id.* at 429-31; *see* El Paso v. Simmons, 379 U.S. 497, 506-07 n.9, *reh'g denied*, 380 U.S. 926 (1965). *But see id.* at 524-25 (Blackmun, J., dissenting).

56. *Blaisdell*, 290 U.S. at 426, 444-45.

57. *Id.* at 438.

reached emergency proportions, and the state legislature tailored it to meet the needs of that problem and emergency. It indicated a concern for both mortgagor and mortgagee and provided for a procedure under the supervision of the court.[58]

The Court's broad language in *Blaisdell* signified the death of Marshallian contract clause analysis, but it did not mark the death of the contract clause. In several subsequent cases during the 1930's, the Court struck down Depression debtor-relief statutes that were not as carefully drafted as the statute in *Blaisdell*.[59] With the possible exception of *W.B. Worthen Co. v. Kavanaugh*,[60] however, these cases did not involve any doctrinal advances.

Not until 1965 did another significant contract clause case come before the Court. *El Paso v. Simmons*[61] arose out of Texas's public land program, under which the state sold land on long-term contracts with the proceeds going to a public school fund. In 1910, Simmons's predecessors in title had purchased land near El Paso from the state pursuant to a statute that provided for forfeiture of the land to the state in the event of nonpayment of interest due under the contract of sale. The statute also provided that, in the event of forfeiture, the purchaser or his vendee could reinstate his claim by requesting reinstatement in writing and paying the past due interest, provided that no third party rights had intervened. In 1941, the state legislature amended the statute to provide that the purchaser or his vendee must exercise his reinstatement right within five years from the date the property was forfeited. Simmons took quitclaim deeds to the property at issue after it was forfeited in 1947, but the State of Texas turned down his request for reinstatement because it came more than five years after the forfeiture. In 1955, the state sold the land to El Paso by special legislation, and Simmons sued to determine title.[62]

Over a vigorous dissent by Justice Black,[63] the Court held that the modification of the reinstatement provision did not contravene the contract clause.[64] Justice White, writing for the majority, based the decision on the police power doctrine. He compared the

58. *Id.* at 445-46.

59. *See, e.g.*, Triegle v. Acme Homestead Ass'n, 297 U.S. 189 (1936); W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935); W.B. Worthen Co. v. Thomas, 292 U.S. 426 (1934). For a discussion of these cases, see WRIGHT, *supra* note 5, at 98-99.

60. 295 U.S. 56 (1935); *see infra* note 317 (discussing the doctrinal aspects of the case).

61. 379 U.S. 497, *reh'g denied*, 380 U.S. 926 (1965).

62. *Id.* at 498-501.

63. *Id.* at 517 (Black, J., dissenting).

64. *Id.* at 509.

problems that Texas faced in administering a land program that had become a vehicle for speculation with the ancillary nature of the reinstatement right in view of the original purposes of the state program.[65] The five-year limitation on reinstatement furthered significant interests of the state and merely prevented speculative purchasers from reaping windfall profits. The limitation protected the legitimate expectations of bona fide purchasers.[66] In short, in light of the changed goals of the public land program and past efforts to improve administration, the contract clause did not forbid an "effective and necessary" measure that imposed only a mild burden on legitimate buyers.[67]

El Paso signified to virtually every commentator that whatever viability was left in the contract clause after *Blaisdell* was gone.[68] The rule appeared to be that a law that is a legitimate exercise of the police power necessarily overrides contract obligations. As Professor Schwartz stated, "This has more than ever removed the Contract Clause as an obstacle to government authority, only emphasizing its contemporary redundant status as a fifth wheel on the constitutional law coach."[69]

III. The Contract Clause and the Burger Court

A. United States Trust Co. v. New Jersey

The controversy in *United States Trust Co. v. New Jersey*[70] was whether New York and New Jersey could use revenues that the New York Port Authority generated (pursuant to a compact between the two states) to develop a rapid transit system despite the fact that the states had pledged those revenues to holders of certain bonds that the Port Authority issued.[71] The states adopted legislation in 1962 authorizing the Port Authority to acquire and operate the Hudson and Manhattan Railroad. In the statute, the states "agreed" with bondholders and the Port Authority that, as long as the bonds were outstanding, neither the states nor the Port Authority would apply any revenues that the states had pledged as security for the bonds to any railroad purposes other than to the

65. *Id.* at 512, 515.
66. *Id.*
67. *Id.* at 516-17.
68. *See, e.g.*, Schwartz, *supra* note 5, at 306: "Whenever a law is legitimate under the police power, it is one that must necessarily override the obligations of contracts." *Id.*
69. *Id.*
70. 431 U.S. 1 (1977).
71. *Id.* at 3.

acquisition and operation of the Hudson and Manhattan Railroad.

The need for rapid mass transit between New York and New Jersey became more imperative in the 1970's, however, and pressure began to build to repeal the 1962 covenant. In 1973, the New York and New Jersy Legislatures repealed the covenant for bonds issued after that date. But continually escalating estimates of the costs of the rapid transit project led the states in 1974 to repeal the 1962 covenant with respect to all bonds.

U.S. Trust, as trustee for some of the bondholders and as an owner of bonds in its own right, sued New Jersey for a declaratory judgment that the repeal of the 1962 covenant violated the contract clause. After a lengthy trial, the New Jersey Superior Court upheld the repeal.[72] The Supreme Court of New Jersey affirmed[73] and U.S. Trust Co. appealed to the Supreme Court of the United States.[74] The Court reversed, holding the repeal unconstitutional.[75]

The *United States Trust* plurality opinion is the starting point for an analysis of the revitalized contract clause.[76] Justice Blackmun's opinion recognized that *Blaisdell* and *El Paso* had severely limited the scope of the clause and that they "largely illuminated" its present role.[77] He then proceeded, however, to a detailed analysis of impairment and justification that is inconsistent with the spirit and results of those cases.

The first question was whether the repeal of the 1962 covenant impaired the obligation of the Port Authority's bonds. The Court found an "impairment" because the repeal had not merely modified or replaced the covenant with a comparable security provision. Instead, it had totally eliminated the covenant.[78] *Blaisdell*, how-

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72. United States Trust Co. v. State, 134 N.J. Super. 124, 338 A.2d 833 (1975).

73. United States Trust Co. v. State, 69 N.J. 253, 353 A.2d 514 (1976).

74. United Trust Co. of New York instituted similar litigation in New York challenging the parallel New York statute. That litigation was still pending in the Supreme Court of New York at the time of the Supreme Court's decision. *United States Trust*, 431 U.S. at 4 n.4.

75. Justice Blackmun wrote the opinion for the Court, with Chief Justice Burger writing a short concurring opinion. Justice Brennan wrote a dissenting opinion joined by Justices White and Marshall. Justice Blackmun's opinion did not have a concurrence of a majority of the Court because Justices Stewart and Powell did not participate.

76. The following discussions of *United States Trust* and *Spannaus* are merely descriptive and are set forth primarily to set the stage for an analysis of the Court's 1983 decisions. To reduce repetition, criticism of the two decisions is deferred until the discussion of *Energy Reserves v. Kansas Power & Light Co.*, *infra* notes 106-40 and accompanying text, and *Exxon Corp. v. Eagerton*, *infra* notes 141-57 and accompanying text, and the subsequent analysis of the scope of the contract clause.

77. *United States Trust*, 431 U.S. at 14-16.

78. *Id.* at 19.

ever, recognized that not every impairment violates the contract clause, so that the finding of a "technical impairment is merely a preliminary step in resolving the more difficult question of whether that impairment is permitted under the Constitution."[79]

Justice Blackmun reasoned that the constitutional impairment issue requires a reconciliation of the contract clause with the "essential attributes of sovereign power."[80] The scope of the state's reserved power depends on the nature of the contractual relationship with which the challenged law conflicts. If the contractual relationship is between two private parties, the *sole* criterion is whether the exercise of the police power is reasonable—and great deference must be given to the legislature's judgment.

When a state impairs its own contractual obligation, however, "the reserved-powers doctrine has a different basis."[81] An initial inquiry that must be made is whether the state had the power to create an irrevocable contract in the first place. Whether the contract involves the taxing, spending, or police power is not dispositive; however, if a state has assumed "financial obligations" under a contract, those obligations are clearly binding.[82] The 1962 covenant was a financial obligation because it related solely to the use of revenues.[83] Therefore, it was validly adopted and binding on New Jersey as a matter of federal constitutional law.

Justice Blackmun then returned to the issue of constitutional impairment. A statute that "technically" impairs a contract does not "constitutionally" impair it if the statute is reasonable and necessary to serve an important public purpose.[84] This impairment standard is the same for both private and public contracts once a court determines that the Constitution protects the contract; but, where a public contract is involved, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake."[85] The impairment

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79. *Id.* at 21. The minority contested the finding. Justice Brennan argued that the covenant was not important to the bondholders and that its repeal did not deprive them of a valuable right. *Id.* at 41-42.

80. *Id.* at 21 (quoting Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 426, 435 (1934)).

81. *Id.* at 23.

82. *Id.* at 24-25.

83. *Id.* at 25. According to Justice Blackmun, not every "security provision" is necessarily financial. For example, a covenant that would obligate the state to continue operating the financed facility could not be construed to prevent the state from closing it for health or safety reasons. *Id.* For a more detailed discussion of this issue, see *infra* note 282 and accompanying text.

84. *United States Trust*, 431 U.S. at 25.

85. *Id.* at 25-26.

is not justified merely because the benefits to be derived from the repeal are greater than the cost to the bondholders.[86] Blackmun argued that the focus is solely on the impairment's effect on the contract, not upon the purposes of the impairment.

Realizing that he was breaking new ground, Justice Blackmun explained the nature of the "reasonable and necessary" test. An impairment is necessary if (a) the legislature's purpose cannot be accomplished by impairment in a less drastic fashion, and (b) alternative means of achieving the legislature's purpose without impairment are not available.[87] Here, the states' total repeal of the 1962 covenant was not essential. Alternative means were available for dealing with the need for mass rapid transit without affecting the bondholders' rights.

The repeal was not only unnecessary, it was unreasonable. The "unreasonableness" test is whether the reason for the impairment was foreseeable in light of the surrounding circumstances at the time the contract was made.[88] The plurality believed *El Paso* was distinguishable because in that case, Texas could not have known, when the contract was made with Simmons's predecessors, that the discovery of oil would make the reinstatement rights so valuable. New Jersey was obviously aware of the problems of congestion and pollution when it made the 1962 covenant. In fact, the covenant did not have a substantially different impact in 1974 than it had in 1962.[89] Chief Justice Burger filed a concurring opinion stressing that a state must show that the impairment was essential to achieve an important public purpose, and that the state did not and could not know the impact of the contract on that state interest at the time the contract was made.[90]

Brennan argued in dissent against both the policy and the doctrine of the Court's opinion.[91] In his view, the Court had prevented New Jersey from dealing with an urgent matter of public health and safety even though the bondholders had suffered no real injury. To impose a more stringent scope of review with respect to public contracts was contrary not only to the Framers' in-

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86. The Court rejected the "invitation to engage in a utilitarian comparison of public benefit and private loss." *Id.* at 29. In light of *Spannaus* and *Energy Reserves*, this point is particularly significant. *See infra* Section VII B.

87. *United States Trust*, 431 U.S. at 29-30.

88. *Id.* at 31-32.

89. *Id.*

90. *Id.* at 32-33.

91. *Id.* at 33 (Brennan, J., dissenting). Justices White and Marshall joined Justice Brennan in dissent.

tent but also to the thrust of constitutional doctrine in the 20th century relating to the adverse claims of property owners. The "reasonable and necessary" standard could only lead to confusion because those terms generally refer in constitutional law to opposing standards of judicial review. Such confusion, Brennan argued, could only lead to judges deciding cases in accordance with their individual inclinations.[92]

In summary, *United States Trust* made four doctrinal statements, two of which were innovative. First, it reaffirmed that the contract clause will proscribe even a minor change in contractual rights if it is not adequately justified. Secondly, it clarified the limit on the police power doctrine—at least financial contracts with a state are binding. Third, it established a new "reasonable and necessary" test to determine impairment with respect to both public and private contracts. Finally, it established a stricter standard of review for public contracts. Courts will not defer to legislative judgment when the state's self-interest is at stake. Whether these innovations would make a difference when a statute affected private contracts remained to be seen.

B. Allied Structural Steel Co. v. Spannaus

In an effort to protect the legitimate expectations of Minnesota employees covered by pension plans, Minnesota enacted a statute requiring any employer that had adopted a pension plan for its employees and then terminated its operations in Minnesota to immediately fund the plan for all employees with ten or more years of service.[93] Allied Structural Steel had adopted a pension plan before the Minnesota Legislature passed the statute and later closed its Minnesota plant. Allied's pension plan did not provide for immediate funding or for one hundred percent vesting at the end of ten years. When the Minnesota Commissioner of Labor and Industry notified Allied that it owed a funding charge of approximately $185,000 (that it would not have been required to make had the statute not been passed),[94] Allied brought suit in federal court challenging the statute's constitutionality.

Justice Stewart, on behalf of the majority, held in a rather short and elliptical opinion that the statute violated the contract clause. Although he cited *Blaisdell* and *United States Trust*, he

92. *Id.* at 54-55 n.17.

93. Minn. Stat. §§ 181B.01-181B.17 (1974) (private pension benefits protection statute).

94. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 239 (1978).

appeared to take an entirely different approach to Allied's constitutional claim. His first inquiry was whether the state law substantially impaired a contractual relationship.[95] A "[m]inimal alteration of contractual obligations might end the inquiry at its first stage," as was the case in *El Paso*, but a "[s]evere impairment . . . pushes the inquiry to a careful examination of the nature and purpose of the state legislation."[96] Stewart reasoned that "the severity of an impairment . . . can be measured by the factors that reflect the high value the Framers placed on the protection of private contracts."[97] One such factor is the right to rely on legitimate contractual expectations free from retroactive changes in obligations.

Applying this analysis to the facts, Justice Stewart found that the Minnesota statute was a severe impairment:

> By simply proceeding to close its office in Minnesota, a move that had been planned before the passage of the Act, the company was assessed an immediate pension funding charge of approximately $185,000.
>
> Thus, the statute in question here nullifies express terms of the company's contractual obligations and imposes a completely unexpected liability in potentially disabling amounts.[98]

The company had relied heavily on the terms of the plan and on the lack of any state regulation when it adopted and implemented the plan.[99]

Justice Stewart then considered whether "this severe disruption of contractual expectations" was necessary to meet an important general social problem.[100] He found that the Minnesota pension law did not satisfy the requirements imposed by the Court in *Blaisdell*, other Depression contract clause cases, and *United States Trust*.[101] First, the statute applied to an extremely narrow class of employers—those who had been "enlightened enough" to adopt pension plans for their employees and, within that class, those who terminated operations in the state.[102] The statute also acted in an area where there had been no prior state regulation of

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95. *Id.* at 244.
96. *Id.* at 245.
97. *Id.*
98. *Id.* at 247.
99. *Id.* at 246.
100. *Id.* at 247.
101. *See supra* notes 52-60 and accompanying text (*Blaisdell* and other Depression contract clause cases); *supra* notes 70-92 and accompanying text (analyzing *United States Trust*).
102. *Id.* at 248.

any type, and it worked a severe and permanent change in the relations between the parties to the contract.[103]

The opinion made no attempt to further define the doctrinal basis of the decision. By stressing the factors that distinguished *Blaisdell* and *El Paso* rather than applying the *United States Trust* test, Stewart seemed to be reverting to pre-*United States Trust* analysis. His reference to the "height of the hurdle" that state legislation must clear implies the balancing approach that Justice Blackmun rejected in *United States Trust*. In short, the *Spannaus* approach is much like that of *Blaisdell* and *El Paso*, but its result is more compatible with *United States Trust*.[104]

Justice Brennan again wrote a dissent in which Justices White and Marshall joined. He argued primarily that the contract clause applies only when a statute diminishes the efficacy of an obligation owed to the constitutional claimant; it does not apply to new duties that legislation has imposed. The latter, he claimed, are to be treated under the due process clause. Because the plaintiff's claim raised an issue only under the due process clause, Brennan analyzed the statute under the traditional rational basis test and found that it passed constitutional muster.[105]

C. Energy Reserves Group, Inc. v. Kansas Power & Light Co.

Five years passed between *Spannaus* and the Court's next contract clause decision. *Energy Reserves Group Inc. v. Kansas Power & Light Co.*[106] involved a dispute between a public utility, Kansas Power and Light (Utility), and an oil and gas company, Energy Reserves Group (ERG), over the application and interpretation of "governmental price escalation" clauses in two intrastate contracts for the sale of natural gas. The clauses permitted ERG to increase the price if a governmental authority permitted higher

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103. *Id.* at 250.

104. *Spannaus* is distinctly reminiscent of Treigle v. Acme Homestead Ass'n, 297 U.S. 189 (1936), which seemed to indicate the narrow reach of *Blaisdell*. In *Treigle*, the Court struck down a state statute changing the order in which shareholders could withdraw from the building and loan association and receive payment. The statute simply changed private priorities and did not further public purposes or deal with an emergency. The Supreme Court, however, virtually overruled *Treigle* in Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940). Faced with a virtually identical statute, the Court found that the state legislature passed the statute to protect the public against the evils of a run on deposits. The *Treigle* decision was "based on the factual conclusion that the statute had no public purpose." *Id.* at 41. The breadth and vitality of *Blaisdell* were thus reaffirmed.

105. *Spannaus*, 438 U.S. at 251 (Brennan, J., dissenting).

106. 459 U.S. 400 (1983).

prices.

In 1978, the federal government for the first time extended federal price regulation to gas sold in intrastate commerce. The federal "maximum price" was approximately seventeen percent higher than the current Utility-ERG price.[107] In response to the federal action, Kansas adopted legislation that in effect prohibited ERG and Utility from considering ceiling prices that the federal authorities set or prices paid under other contracts in Kansas in setting prices under their price escalation or price determination clauses.[108] The Kansas legislation therefore precluded ERG from raising its price to meet the market, which was the purpose of the clauses, and from terminating the contracts, which was its remedy if Utility did not agree to increases.

The Supreme Court of Kansas rejected ERG's contract clause claim on the grounds that an emergency existed and that Kansas had a legitimate interest in controlling the "economic dislocation" that a sharp increase in gas prices would cause. The Court concluded that the means chosen to achieve that interest—namely, the postponement of price increases—were reasonable.[109]

The Supreme Court of the United States unanimously affirmed the decision of the Supreme Court of Kansas. Justice Blackmun, the author of the plurality opinion in *United States Trust*, wrote the opinion of the Court. Blackmun began his discussion of the contract clause claim by stating that the *Blaisdell* court had balanced the *language* of the clause against the state's police power interest.[110] This is a curious balancing notion. Balancing is a method of deciding constitutional claims on a case-by-case basis, whereby the specific interests that the competing doctrines protect are balanced. Such a balancing test requires consideration of the state's interest as opposed to the private interest affected by the statute. Under Justice Blackmun's balancing test, however, the Court balances the constitutional doctrines themselves. Justice Blackmun's rule of law, like that adopted in *Stone v. Mississippi* or *El Paso*, subordinates the contract clause to the police power.

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107. *Id.* at 415 n.21 and 417 n.24. The contract price was $1.77; the federal maximum price for intrastate gas was $3.152. *Id.*

108. The federal maximum price for interstate gas (the maximum permitted by the Kansas statute) was $2.194. *Id.* The maximum rate permitted by the Kansas statute was twenty-four percent over the contract price, but the statute delayed the effective date of the full increase. *Id.* at 407-08.

109. Energy Reserves Group v. Kansas Power & Light, 230 Kan. 176, 630 P.2d 1142 (1981).

110. *Energy Reserves*, 459 U.S. 400, 410 (1983).

The Court's use of precedent in explaining the impairment issue indicates that foreseeability is the determining factor.[111] Justice Blackmun stated that it is not an impairment to restrict a party to its reasonable expectations and, in determining those expectations, the courts must consider to what extent the state and federal governments have regulated the subject matter.[112]

The regulation aspect was extremely important in *Energy Reserves*.[113] When ERG and Utility entered into the contracts, Kansas supervised the industry and the federal government controlled interstate prices. Kansas did not control intrastate prices between producers and utilities, but its authority over consumer prices apparently limited the utilities' willingness to accept price escalation clauses. Moreover, federal regulation of interstate prices kept a ceiling on intrastate prices.[114] The fact that the parties had agreed that all contract terms were subject to changes in federal and state law was especially significant. ERG seemed to have taken the risk that what deregulation gave, later regulation could take.

Justice Blackmun concluded that the Kansas Act had not impaired ERG's reasonable expectations.[115] The Court used the impairment concept as it did in *United States Trust*, wherein the preliminary question was whether the state must justify its action and *not* whether the state had violated the contract clause. ERG was not entitled to any benefit from federal deregulation because it had not bargained for that right.[116] Therefore, there was no impairment—"substantial" or "technical."

Indeed, the state law problems facing ERG on the interpretation and impairment issues were severe enough that Justice Pow-

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111. 459 U.S. at 411.

112. *Id.* In this respect, the approach of *Energy Reserves* is identical to Justice White's in *El Paso*. *See supra* text accompanying notes 65-67.

113. *See Energy Reserves*, 459 U.S. at 413-14 nn.15-18 (providing detailed references to the extent of regulation of natural gas production and sale).

114. *Id.* at 406. The opinion makes it clear, however, that past regulation in itself is not determinative. *Id.* at 415-16. The parties in *Energy Reserves* drafted the clauses in view of existing regulation. Although the court did not cite any trial testimony regarding the parties' intent, it found that ERG never intended to get the benefit of "deregulated" prices but merely of "anticipated increases." *Id.* at 415.

115. *Id.* at 416.

116. "Bargained" is used here advisedly. There is no indication that parties must actually negotiate terms for a claimant to demonstrate that a protected contract right exists. Rather, it should be enough that the parties have "agreed" on the contract provision. *See* U.C.C. §§ 1-201(3), 1-201(11) (1977). Although the opinion is not explicit on this point, an argument could be made that the clause was unenforceable against Utility under the doctrine of failure of presupposed conditions, even in the absence of the Kansas statute. U.C.C. § 2-615 & comment 9 (excuse by failure of presupposed conditions).

ell, joined by Chief Justice Burger and Justice Rehnquist, determined that the lack of impairment was dispositive as a matter of contract law.[117] Justice Powell, therefore, refused to join that part of the Court's opinion that considered the significance of the state's interests.[118]

The Court's opinion, however, did proceed to the second part of the contract clause equation, with less than satisfactory results. The rule adopted is that "[i]f the state regulation constitutes a substantial impairment, the State . . . must have a significant and legitimate public purpose behind the regulation."[119] If the Court really meant that both the legitimacy and importance of the state's interest are relevant, the test under the contract clause is more stringent than the due process rational basis test.[120] The Court's opinion indicates that two types of state interests may satisfy the test. The first is one that remedies a "broad and general" social problem.[121] The broad/general qualification is intended to ensure that "the state is exercising its police power, rather than providing a benefit to special interest."[122]

The problem with such a test is that the language is so imprecise that it would apply to most legislation.[123] The impetus for leg-

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117. *Energy Reserves*, 459 U.S. at 421 (Powell, J., concurring in part).

118. Justice Blackmun's only response to the separate opinion is an indirect one. *See id.* at 410 n.10. The note does not relate directly to the impairment issue but instead to the effect of the federal deregulation statute.

119. Energy Reserves Group Inc. v. Kansas Power & Light, 459 U.S. 400, 411 (1983) (citing *United States Trust*, 431 U.S. at 22).

120. The use of "significant" necessarily implies some notion of balancing. The due process rational basis test demands "that the law shall not be unreasonable, arbitrary, or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained." Nebbia v. New York, 291 U.S. 502, 525 (1934). Under this test, the legislature enjoys a presumption of validity while the challenger faces a substantial burden of proof. In the realm of economic due process, the presumption of constitutionality was given perhaps its fullest expression in Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1975) ("It is by now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary an irrational way."). *See also* United States v. Carolene Products Co., 304 U.S. 144 (1938) ("regulatory legislation . . . is not to be pronounced unconstitutional unless in the light of the facts made known or generally assumed it is of such a character *as to preclude the assumption* that it rests upon some rational basis").

121. Energy Reserves Group Inc. v. Kansas Power & Light, 459 U.S. 400, 411-12 (1983) (citing Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 247, 250 (1978)).

122. Energy Reserves Group Inc. v. Kansas Power & Light, 459 U.S. 400, 412 (1983).

123. The Court attempted to explain and limit the concept in a footnote discussing *Spannaus*. *See* Energy Reserves Group Inc. v. Kansas Power & Light, 459 U.S. 400, 412 n.13 (1983). The footnote, however, simply overstates the *Spannaus* facts in a conclusory fashion that would deprive the decision of all meaning. The legislation in *Spannaus* may have been

islation is frequently the "bad apple" case—that is, a case that represents one incident rather than a widespread problem. Moreover, legislatures pass virtually all legislation, as Judge Posner argues,[124] to benefit a "special interest." Who else would work for its passage? Legislation is seldom neutral, and those who benefit, whether it be consumers, big business, labor, farmers or utilities, can be termed "special interests." Only if the Court's concept means that the many can oppress the few but that the few cannot oppress the many, does it have much meaning. That meaning, however, would turn the contract clause on its historical head. After all, the primary purpose of the clause was to prevent debtor classes from passing special interest legislation to relieve them of the burden of their debts.

The second type of legitimate state purpose that the *Energy Reserves* Court recognized is the "elimination of unforeseen windfall profits."[125] Such a purpose is, of course, consistent with general contract law because it rests on the assumption that bargains do not contemplate the unforeseeable.[126] It is a contradiction to state that a windfall was a risk a party assumed or that a court in enforcing a contract is awarding true windfall profits. Therefore, legislation that is intended to do no more than eliminate windfalls is consistent with the contract clause. This is so because such legislation seeks to ensure the integrity (some would say the sanctity) of contracts by not permitting enforcement or abrogation to depend on unforeseen events or the other party's political power.

Energy Reserves recognizes that legislation supported by a legitimate state purpose cannot ride roughshod over contractual interests. In *United States Trust*, the Court phrased the test as whether the legislation is "reasonable" and "appropriate,"[127] but *Energy Reserves* makes it clear that deference to the legislature where the state is not party to the contract is as complete as under the rational basis test.[128]

Thus, it appears from *Energy Reserves* that much of the bite

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complex and of narrow application, but it was not atypical in origin.

124. Posner, *Economics, Politics and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263 (1982).

125. 459 U.S. at 412 (citing *United States Trust* Court's discussion of *El Paso*).

126. *Cf.* Hadley v. Baxendale, 156 Eng. Rep. 145 (1854) (damages for breach of contract must arise naturally from the breach or must have reasonably been in contemplation of both parties at time of contracting); Krell v. Henry, 2 K.B. 740 (1903) (impossibility of performance).

127. *United States Trust*, 431 U.S. at 22.

128. *Energy Reserves*, 459 U.S. at 418-19.

of the contract clause may be gone. Although Justice Blackmun has not recanted his *United States Trust* position, his latest contract clause opinion in *Energy Reserves* indicates that his former position will be limited to the public contract arena.[129] Blackmun's current position may result from his shift to the Brennan-Marshall camp[130] and not from a reluctance on the Court's part to experiment with new standards of review. Presuming that the Court has not given up on the ghost of *United States Trust*, it is the primary purpose of this Article to urge that the Court should not allow *United States Trust* to be a mere phantom on the constitutional scene, but rather that the Court should clarify what state interests justify an impairment.

Energy Reserves, however, gives little hope that any such refinement is forthcoming. The Court first cited Kansas's need to protect its consumers as the state purpose justifying the statute.[131] The issue before the *Energy Reserves* Court, however, was which party to the gas contract should bear the original incidence of deregulation and reregulation. The issue did not concern consumers.

The other state purpose the *Energy Reserves* Court relied on was Kansas's interest in correcting the imbalance between intrastate and interstate prices.[132] The federal statute created the anomalous possibility that Kansas citizens would have to pay more for Kansas gas than for Oklahoma gas. One can see why Justice Powell thought that the Court should not reach the justification issue.[133] The Court's opinion left solid ground on the impairment issue only to fall into quicksand on the issue of legitimate purpose. Kansas clearly has an interest in seeing that its citizens do not pay more for Kansas gas than out-of-state consumers do. But the issue in this case was much narrower: Does ERG or Utility bear the loss from unanticipated deregulation? Or, to put it in contract clause terms, can a state determine by legislation which of two parties to a contract must bear the risk of an unanticipated event? The Court, relying on the Congressional Conference Report explaining the federal act,[134] established the legitimacy of Kansas's purpose, thereby at least hinting that a state may so allocate the risk of an

129. Justice Blackmun is careful to distinguish the public contract situation. *Id.* at 412 n.14.

130. Note, *The Changing Social Vision of Justice Blackmun*, 96 HARV. L. REV. 717, 717 (1983).

131. *Energy Reserves*, 459 U.S. at 417.

132. *Id.*

133. *Id.* at 417 (Powell, J., concurring in part).

134. *Id.* at 421.

unanticipated event.

The Court, having hinted at the answer, should have determined whether ERG's profits would in fact be a windfall. Even if ERG or Utility did not in fact *expect* deregulation when they executed the contracts in 1975, the Court should have decided the issue of whether deregulation was *foreseeable*.

The Court was even more deferential in its review of the record part of the *United States Trust* test: the reasonableness of the means by which Kansas corrected the imbalance between intrastate and interstate prices.[135] As indicated above, even if one assumes the validity of a proconsumer purpose, the statute did not achieve this purpose in a manner that was least harmful to ERG's contract interest.[136] There may have been cogent reasons why Kansas decided not to make Utility bear the price burden, but the Court did not even investigate those reasons. The Court merely pointed out that "on the surface" the Act affected less than ten percent of the natural gas consumed in Kansas and that the scope of the Act was limited to intrastate contracts with indefinite escalators.[137] In short, the statute satisfied the means requirement because it simply completed price regulation of the gas market by imposing gradual escalation mechanisms on the intrastate market consistent with national policy.

There can be little argument with the notion that simply graduating price increases is a reasonable method of dealing with the problem of deregulation once the power to "impair" the contract is established. The Court approved the same approach with respect to mortgages in *Blaisdell*.[138] But the Court in *Energy Reserves* was avoiding the real issue. The narrow scope of the Kansas statute was not relevant to the question of the reasonableness of the statute because no claim was made that it was overbroad. Indeed, ERG argued that the Kansas Legislature passed the statute for

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135. *Id.* at 412-13, 416-17.

136. The "least harmful" concept, that was implicit in *Blaisdell*, was made explicit in *United States Trust*. *See United States Trust*, 431 U.S. at 29-30; *supra* notes 84-89 and accompanying text. The only difference between *United States Trust* and *Energy Reserves* on this issue is the degree of deference to be given to the legislature's judgment. Of course, without explicit findings by the legislature as to alternative means, the Court is left to draw its own conclusions. *Cf.* Zobel v. Williams, 457 U.S. 55 (1982) (Alaska dividend distribution of mineral income fund violated equal protection clause). The difference between a less strict standard of review and greater deference to legislative judgment is chimerical. At least part of the Court has recognized this in the equal protection area. *See* Schweiker v. Wilson, 450 U.S. 221, 239 (1981) (Powell, J., dissenting).

137. *Energy Reserves*, 459 U.S. at 418.

138. *See supra* notes 107-10 and accompanying text.

Utility's benefit.[139] Nonetheless, the Court acknowledged that the Governor, organized labor, farmers, and municipal representatives supported the bill, and both Houses of the Kansas Legislature passed it by a wide margin.[140] Presumably, the statute promoted the interest of others in addition to that of Utility.

The Court's emphasis on the narrow scope of the legislation is particularly interesting because it tended to show that the legislation was not aimed at a broad social problem and that there was therefore no "legitimate state purpose." There is an inherent tension between showing that the problem is important enough to affect contracts and that the legislation is narrow enough to preclude significant impairment of the constitutionally protected right to contract. Apparently, only legislation that satisfies both criteria can survive a contract clause challenge.

D. Exxon Corp. v. Eagerton

Exxon Corp. v. Eagerton[141] also involved the oil and gas industry. An Alabama statute increased the severance tax on oil and gas extracted from wells in the state, but exempted royalty owners from the increase and prohibited producers such as Exxon from passing on the increases to consumers. Exxon and other oil companies claimed that this "pass-through prohibition" was invalid under the supremacy clause with respect to sales of gas in interstate commerce and that both the royalty owner exemption and the pass-through prohibition violated the contract clause.[142] The Supreme Court of Alabama held the act valid in its entirety.[143] The Supreme Court of the United States reversed on the preemption issue with respect to interstate commerce but affirmed on the contract clause issue, holding that the statute was valid as applied to contracts for intrastate shipment.[144]

Justice Marshall, writing for a unanimous Court, made short shrift of the argument that the royalty owner exemption violated the clause. The oil and gas leases in effect when the Alabama Legislature passed the statute provided that the producers and royalty owners would bear taxes in proportion to their interests.[145] Mar-

139. *Energy Reserves*, 459 U.S. at 407 n.6.
140. *Id.*
141. 103 S. Ct. 2296 (1983).
142. *Id.* at 2300.
143. Eagerton v. Exchange Oil & Gas Corp., 404 So. 2d 1 (Ala. 1981).
144. *Exxon Corp.*, 103 S. Ct. at 2309.
145. *Id.* at 2300.

shall reasoned that the contracts thus permitted the producer to recover from the royalty owners their share of a tax increase regardless of whether the "legal *incidence* of the tax increase" fell on the producer or the royalty owner.[146] Because the statute did not prohibit reimbursement and by its terms dealt only with incidence, it did not affect any right of the producer.[147] Even if the contract did not permit the producer to recover the increase, the statute did not raise a contract clause issue because the *contract*, not the statute, created no obligation of the royalty owners to reimburse the producers for the tax increase.[148] In short, under Marshall's interpretation, the Alabama statute had a neutral effect. Like any statute, it may have raised the cost of doing business, but it did not itself shift rights between contracting parties. Thus, the statute did not even "technically" impair the leases.

The Court found that the pass-through prohibition, however, did clearly affect the appellants' contract rights because they were parties to contracts that permitted them to include in their prices any increase in severance taxes.[149] The fact, however, that the pass-through prohibition thus nullified the purchasers' contractual obligations to reimburse appellants did not in and of itself make the statute unconstitutional.[150] Justice Marshall cited general maxims from *United States Trust*, *Spannaus*, and 19th and early 20th century cases, regarding the inherent power of the state to exercise its police power[151] and relied principally on two cases from 1937 and 1920 that upheld statutes permitting utility commissions to change contract rates.[152]

What makes the case interesting is Marshall's attempt to rec-

146. *Id.* at 2304 n.9.
147. *Id.* at 2304-05.
148. *Id.* at 2304 n.9.
149. *Id.* at 2305.
150. *Id.* at 2305-07.
151. *Id.* at 2305-06.
152. *See* Midland Realty Co. v. Kansas City Power & Light Co., 300 U.S. 109 (1937); Producers Transp. Co. v. R.R. Comm'n, 251 U.S. 228 (1920). The *Midland Realty* opinion says little more than that utilities have no rights under the clause with respect to rates. The facts indicate a very weak reliance argument because the utility exercised its option to extend its service contract with the user after the Missouri Legislature passed the public service commission statute under attack was passed. The reliance on *Producers Transportation* is misplaced. Justice Van Devanter based his holding on the fact that the claimant was a common carrier that had obtained its right of way by the exercise of eminent domain and had therefore devoted its property to public use and regulation. *Id.* at 231-32; *cf.* New Haven Inclusion Cases, 399 U.S. 392 (1970) (investors in railroads assumed the risk of reorganization losses when they invested in a public utility); *infra* note 179. In short, *Exxon* may have little impact outside the public utility arena.

oncile prior police power cases with *United States Trust* and *Spannaus*. The opinion seems to treat legitimate purpose and reasonable means as one concept. Marshall claimed that the statute was not limited in effect to contract rights but imposed a general rule that protected consumers from excessive prices resulting from Exxon's passing on the cost of its tax increase. He further reasoned that the pass-through prohibitions applied to all contracts, not just those with provisions permitting pass-throughs.[153] The adverse effect on Exxon was "incidental" to its "main effect" of shielding consumers from the tax increase.[154]

Marshall distinguished *United States Trust* and *Spannaus* on the ground that they involved statutes whose *sole effect* was to change contracts. Marshall's logic leads to the conclusion that a statute constitutional on its face cannot be unconstitutional as applied. Because the statute did not deal only with contract obligations, it could not violate the contract clause. If *Exxon* is in fact the Court's new approach, the current test apparently is whether the effect on contract obligations is "direct" or "incidental" to the primary purpose of the statute.[155]

Marshall's opinion is a typical contract clause opinion in that it oversimplifies the issues by relying on the police power doctrine. The purpose of the Alabama statute was to protect consumers from bearing the financial burden that would result from an oil company's tax increases. No one questioned Alabama's right or power to increase severance taxes on oil or even to prohibit severance altogether. The question was whether Alabama could by statute affect pre-existing contract rights.[156] The putative purpose of the contract clause is to prevent states from adopting exactly this type of class legislation.[157] If the Alabama Legislature passed a statute to protect consumers from excessive interest rates and in-

153. *Exxon*, 103 S. Ct. at 2306.

154. *Id.*

155. The Court in Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934), expressly rejected a direct versus an incidental approach. *See id.* at 438. In any event the *Exxon* approach appears to reduce greatly the significance of the fact that a legislature has regulated heavily the activity that the challenged statute covers. *Spannaus* and *Energy Reserves* both placed heavy emphasis on this factor, but *Exxon* reduces its importance to a footnote. 103 S. Ct. at 2307 n.14.

156. Justice Marshall noted this distinction in his discussion of the royalty owner exemption. *Id.* at 2304-05. There the statute's only subject was the incidence of the tax, not its ultimate burden.

157. *Cf.* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 256-57 (1978) (Brennan, J., dissenting) (framers intended contract clause to apply only to laws that impaired contracts by effectively relieving one party of the obligation to perform).

flation by prohibiting lenders from collecting accrued interest on existing debts, there could be no doubt that the statute would violate the contract clause. What, then, was different about the pass-through prohibition? It could be that the Court viewed the statute as essentially a tax measure; and, although the power to tax is the power to destroy, the Framers could not have intended the contract clause to interfere with a state's taxing power. Or, it could be that the statute did not interfere with any reliance interest of the producers. In short, protection of debtors or consumers at the expense of other parties to contracts can be, but is not always, a "legitimate" state purpose. Unfortunately, *Exxon* only adds to the mystery of when a state purpose is "legitimate."

E. *The Contract Clause Today*

The Court's 1983 decisions may appear to reinterpret the contract clause, but a closer examination demonstrates that the Court did not on the facts or reasoning limit either *United States Trust* or *Spannaus*. Moreover, the Court clearly left unresolved most of the uncertainties that the Burger Court decisions created. *Energy Reserves* and *Exxon* presented garden variety contract clause claims that probably would have failed under the analyses of *United States Trust* and *Spannaus*. In *Energy Reserves*, the contract impairment claim was tenuous, and in light of the amount of government regulation, one would be hard pressed to find any real reliance argument.[158] In *Exxon*, one statute did not affect the parties' right to contract at all and the other only tangentially affected Exxon's rights. The legislation's impact was to simply impose a tax on Exxon.[159] The contract clause cannot be interpreted to prevent a state from adopting an obvious revenue measure, the incidence of which falls on some but not all contract rights. Of course, *Energy Reserves* did attempt to cut back on the sweep of *Spannaus* and *United States Trust*, but as the concurring opinion pointed out, most of the analysis was unnecessary to the decision.[160] It remains to be seen what the Court will do with a case that involves a conflict between a reliance interest and an important state policy.

To the extent that they survive *Energy Reserves* and *Exxon*, *United States Trust* and *Spannaus* question the constitutionality

158. *See supra* text accompanying notes 106-40 (discussing the *Energy Reserves* decision).

159. *See supra* text accompanying 141-57.

160. *Energy Reserves*, 459 U.S. at 421 (Powell, J., concurring in part).

of statutes governing a wide range of activities.[161] *United States Trust* is particularly significant in the public contract arena. On the one hand, fiscal responsibility measures have forced many state and local governments to curtail their obligations under long-term collective bargaining and capital improvement agreements.[162] On the other hand, acceptance of public participation in and control over health care, pollution and waste management, and transportation and economic development, mean that the complexity and magnitude of government contracts could present a plethora of constitutional challenges to legislation affecting those same contracts and projects. Until the Court addresses another public contract case, one must assume that the 1983 decisions have not affected the impact of *United States Trust* on public contracts.

Although *United States Trust* may have made the contract clause more significant in the public contract arena, it would be a perverse reading of the clause and the police power doctrine to say that it applies as a practical matter only to public contracts. The Court has utterly failed to develop a cohesive doctrine that applies to both public and private contract cases. The remainder of this Article attempts to fill that void.

IV. Contract Rights Protected by the Contract and Taking Clauses

A. *Contract Rights as Property Rights*

United States Trust and *Spannaus* were criticized because they seemed to give more constitutional protection to contract rights than that available to other forms of property. It cannot be denied, however, that the clause singles out contract rights for spe-

161. The public has attacked many state laws in the federal and state courts. *See* Continental Ill. Nat'l Bank v. Washington, 696 F.2d 692 (9th Cir. 1983) (Washington referendum requiring voter approval of bonds to build nuclear power plants); Northwestern Nat'l Life Ins. Co. v. Tahoe Regional Planning Agency, 632 F.2d 972 (9th Cir. 1980) (regional land use plan that allegedly impaired assessment bonds); Morseburg v. Babylon, 621 F.2d 972 (9th Cir. 1980) (California statute requiring payments to artists by remote buyers of fine art); Pomponio v. Claridge of Pompano Condominium, Inc., 378 So. 2d 774 (Fla. 1980) (statute requiring the deposit of disputed rents into the court registry); Smith Ins. Inc. v. Grievance Comm., 424 A.2d 816 (N.H. 1980) (statute creating a grievance committee for insurance agency terminations); Wipperfurth v. U-Haul of W. Wis., 304 N.W.2d 767 (Wis. 1981) ("fair dealing" law requiring good cause for terminations).

162. Even before *United States Trust*, the Second Circuit in Koch v. Yunich, 533 F.2d 80 (2d Cir. 1976), rejected a contract clause challenge to a section of the New York Civil Service Law, which in cases of layoff and demotions for economic reasons, requires termination by seniority based on original permanent retention in civil service rather than tenure in positions currently held.

cial protection. This portion of the Article analyzes the nature of the contract rights that the contract clause protects.

Any contractual right is property in the sense that it represents a claim of entitlement to resources of the other party or parties to the contract. The recent Supreme Court decisions and academic commentary, however, have refined the concept of property in ways that permit distinctions to be drawn among contract rights. For example, an inverse condemnation proceeding can be deended on the ground that the plaintiff had no "property" interest under state law[163] or under the Constitution,[164] or that any government interference with the "property" interest was insufficient to constitute a taking.[165] All three defenses generally require more sophisticated concepts of property than the Court has been required to consider in contract clause cases. That does not mean, however, that the problems do not exist in contract clause cases.

A person may by contract obtain a particular interest in specific property of the other contracting party. Such a contract right, whether it is called a mortgage,[166] a leasehold[167] or a security interest,[168] is generally thought of as an interest in the specific resource—one of the bundle of rights that constitute "ownership." For that reason, such cases are usually litigated as taking and due process cases rather than contract clause cases. Yet, *Blaisdell* and *Fletcher v. Peck* demonstrate that the contract clause is clearly

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163. *See* Texaco v. Short, 454 U.S. 516, 530 (1982). Inverse condemnation is a cause of action against a government agency to recover the value of property that the agency took, although the agency has not completed a formal exercise of the power of eminent domain. BLACK'S LAW DICTIONARY 740 (5th ed. 1979).

164. *See* Michelman, *Property as a Constitutional Right*, 38 WASH. & LEE L. REV. 1097 (1981). *But see* Pruneyard Shopping Center v. Robbins, 447 U.S. 74, 88-89 (Blackmun, J., concurring). The Court in *Pruneyard*, upheld a California constitutional provision that elevated free speech interests over the landowner's property interests. *Id.* at 82. The landowner had a "property right" to exclude persons but not on the basis of their speech. The same distinction may exist under the United States Constitution.

165. *See* Agins v. Tiburon, 447 U.S. 255 (1982); Penn Cent. Transp. Co. v. New York, 438 U.S. 104 (1978).

166. *Blaisdell* involved a mortgage on real property, which is a contract that creates an interest in the land mortgaged.

167. Texaco v. Short, 454 U.S. 516 (1982) (The case involved statutes relating to "lapsed" mineral rights where landowners gave leases of mineral rights to oil companies subsequent to the effective date of the statute. The Court rejected both the taking and impairment claims.).

168. United States v. Security Industrial Bank, 459 U.S. 70 (1982) (The case involved the validity of security interests in consumer personal and household goods under the Bankruptcy Reform Act of 1978. The Court held that the Act applied prospectively only, because an interpretation permitting retroactive application of the statute would raise serious taking issues.).

available.[169] From the viewpoint of positive law, such contract rights are, however, easily distinguishable from mere promises to perform an act or pay money. For example, in *Energy Reserves*, Utility's refusal to pay ERG the deregulated price for gas, even if it had actually promised to do so, would not give ERG the legal right to any property of Utility. Rather, ERG's contract right was simply to recover damages from Utility if it did not pay in full for the gas. Most contract rights, then, differ from property rights because they do not represent a claim to dominion over specific resources.[170] They are legal property, not "layman's" property, and as one author demonstrates, they are less likely to be perceived as "takable."[171] The Supreme Court implicitly drew this distinction in *Loretto v. Teleprompter Manhattan CATV Corp.*,[172] which held that a permanent occupation or destruction of real estate establishes a taking without the need for the more sophisticated balancing of economic interests involved in analyzing a claimed taking of only a partial interest in tangible property.

The distinction between the two extremes of the contract right spectrum may help illuminate more difficult cases, such as *United States Trust* and *Spannaus*. The "right" involved in *United States Trust* was the obligation of the Port Authority not to use its revenues for commuter trains. This "negative pledge" gave the bondholders no legal rights to the revenues themselves, but it gave them greater comfort that the Authority would have sufficient assets to pay the bonds when due. In other words, the covenant gave them no right other than that they were the beneficiaries of the Authority's *obligation* not to use the revenues for other purposes. Certainly the repeal of the statutory covenant did not affect in any way the absolute obligation of the Authority to pay the bonds. What the legislative repeal affected was the creditors' important security provision.[173] The repeal can therefore be viewed in two different ways. First, one could argue that it totally destroyed the *negative* pledge. Under the permanent occupation or total destruc-

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169. *See Blaisdell*, 290 U.S. 398; Fletcher v. Peck, 10 U.S. (6 Cranch) 87, 139 (1810) (land grant).

170. Professor Rogers has argued convincingly that there is no constitutional difference between secured and unsecured claims. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 988-95 (1983).

171. *See* ACKERMAN, PRIVATE PROPERTY AND THE CONSTITUTION 118-21 (1977).

172. 458 U.S. 419 (1982).

173. Justice Brennan refused to concede that even this "practical" effect had occurred. United States Trust Co. v. New Jersey, 431 U.S. 1, 43 (1977).

tion theory of *Teleprompter*, it would follow that the bondholders' property was taken and that the obligation of the contract not to use revenues was reduced or impaired. This same result, however, would not follow as readily if the second view were taken—that the repeal had no direct effect on the ultimate legal obligation to pay the bonds. The bondholders' right under the bond contract to receive payment and their "legal" right to recover for damages if payment was not made remained unaffected.

Much of the testimony at trial in *United States Trust* concerned the actual and potential impact of the repeal on the value of the bonds and the likelihood of payment.[174] If, as the state argued, the bondholders had more than adequate assurance of repayment even after repeal,[175] then there was no taking or impairment of a "property" or "contract" right because there was no property interest. This is so because a necessary element of the concept of property, at least in the absence of a government edict, is value. The right to use a limited or scarce resource, or to exclude others from using it, must have an economic value. If everyone could use the resource without interfering with the use of others, no one could command payment from another for the right to use it. In other words, only when a resource is scarce, in the sense that not everyone can use it, is there any reason for the law to become involved in determining whose "rights" are paramount. Conversely, if a resource such as money, for example, is scarce, any right relating to that resource that is not valuable must not be a property right—it must not be a "right" that is recognized and enforceable

174. United States Trust Co. v. State, 134 N.J. Super. 124, 176-82, 338 A.2d 833, 863-66 (1975).

175. Appellee's Motion to Dismiss at 8-10, United States Trust Co. v. State, 134 N.J. Super. 124, 338 A.2d 833 (1975). The state argued that the fact that the bonds kept their "A" rating, even after repeal, evidenced a lack of injury to the bondholders and that the only reason for the covenant was that the Authority itself did not want to be involved in the rail business. In short, the investors had not bargained for the covenant that was designed to protect the issuer, not the bondholders. Finally, the state argued that it could not reasonably be believed that the state would harm the bondholders because the state continuously needed to raise capital in the bond market; and it, therefore, could not afford to kill the golden egg-laying goose.

The U.S. Trust Company argued that the repeal injured the bondholders because the price of the bonds affected fell from six to twelve points when the repeal was announced. Furthermore, the fact that the Authority was "forced" to give New Jersey and New York $120 million each for mass transit purposes, after the New Jersey court's decision in favor of the Authority, demonstrated the repeal's effect on the Authority's revenues. Jurisdictional statement at 14. The appellants relied on Fiske v. Kansas, 274 U.S. 380 (1927), to support their contention that the Supreme Court of the United States could make its own determination of the facts from the record.

in court.[176]

If New Jersey in *United States Trust* was correct that the repeal of the covenant had absolutely no measurable effect on the possibility of repayment, the bondholders would have had no legal or equitable remedy for breach by the Authority. The bondholders could not have shown any out-of-pocket loss to recover damages, and an injunction would not have been available because the possibility of any irreparable injury was remote. In short, the "contract right" was not "property" because the availability of legal enforcement, which is what makes a mere contract right a property interest, was missing.[177]

This analysis demonstrates the importance under current law of identifying the obligation or right that is impaired or taken. Although focusing on the narrowest contractual provision is likely to produce impairment, focusing on the basic bargain is not. There does not seem to be a clearly correct rationale for choosing one characterization over another. But, as discussed in detail below,[178] the right ultimately identified should not affect the value question; thus the issue of whether a statute destroys or merely regulates a contractual right should not be significant.

B. *Contract Rights and Contract Obligations*

In contrast, precise definition of the *nature* of the contract right involved is perhaps the most significant factor involved in determining whether the right is constitutionally protected from regulation that does not affect even a total destruction of the right.[179]

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176. "But not all economic interests are 'property rights'; only those economic advantages are 'rights' which have the law back of them, and only when they are so recognized may courts compel others to forbear from interfering with them or to compensate for their invasion." United States v. Willow River Power Co., 324 U.S. 499, 502 (1945).

177. Faitoute Iron & Steel Co. v. Asbury Park, 316 U.S. 502 (1942), established the outer perimeters of the contract clause in this regard. There, a bondholder objected to a reorganization of a city's debts on the grounds that it changed the payment terms of its bonds. The Court rejected the claim on the ground that the bonds were worthless unless a reorganization took place; events had made the claimant's rights theoretical and the Constitution protects rights, not theories.

178. *See infra* text accompanying notes 212-17.

179. *Teleprompter* and *United States Trust* hold that the Constitution will not countenance a total destruction of property by a statute. *Exxon* could be viewed as a contrary holding, but the Court's rationale was that Exxon never had a *right* to pass through increased costs because its ability to do so was always subject to the police power. *Cf.* New Haven Inclusion Cases, 399 U.S. 392, 491-95 (1970) (investors in railroad assumed the risk of reorganization losses when they invested in a public utility). These decisions are thus consistent with the ensuing discussion of the importance of identifying reliance interests in the constitutional context.

Spannaus illustrates the distinction between identifying the right and determining its nature. In *Spannaus*, the Minnesota pension statute imposed an additional obligation on the employer, Allied Structural Steel Company. Justice Stewart viewed the statute as impairing Allied's unfettered discretion to terminate its pension plan for Minnesota employees or to simply terminate the employment relationship with those employees. Certainly, if the agreement establishing the plan had included a provision permitting Allied to terminate at any time, Allied would in fact have had a *contractual* right to terminate.

But even if Allied had the *right* to terminate the contract, it does not necessarily follow that legislation affecting that right "impaired the *obligation* of the contract" so as to invalidate it under the language of the contract clause.[180] The problem lies in establishing what type of property right the phrase "obligation of contract"[181] protects. In *Spannaus*, Justice Brennan argued in dissent that a statute that merely imposed a new obligation on a contracting party could not violate the contract clause.[182] The major-

180. *See* Garris v. Hanover Ins. Co., 630 F.2d 1001 (4th Cir. 1980). In *Garris*, the Fourth Circuit held invalid a statute prohibiting insurers from terminating agents because of the amount of assigned risk insurance they generated. The court found a substantial impairment of the insurer's contractual right to terminate without cause because the statute in effect subjected every termination "to costly and disruptive legal challenges" requiring the insurer to demonstrate that termination had not resulted from assigned risk policies that an agent generated. The court's emphasis on freedom from litigation as a property right of sorts is not appealing. In a sense, an inherent attribute of the ownership of property is the need to protect it against infringement; the ultimate evidence of the "ownership" of a contract right is the ability to fend off a lawsuit challenging that right. To say that government action that encourages "unmeritorious" litigation impairs the right is thus putting the cart before the horse. *Cf.* Agins v. Triburon, 447 U.S. 255, 263 n.9 (1980) (institution of condemnation proceedings may affect the value of property, but that is merely an incident of ownership).

181. State contract law precludes enforcement of many contract "rights," including those in gambling contracts and those involving penalties and forfeitures. A contract right is a property right only if it is enforceable as a matter of nondiscriminatory state law or if it is rooted in some noncontract property right of the other party, as is the case with a pledge.

Most state law restrictions on the enforcement of contractual rights do not raise contract clause issues because the clause applies only to legislation not to judicial acts. McCoy v. Union Elevated R.R., 247 U.S. 354, 363 (1918). One rationale is that judges merely apply the law as others have always applied it. Another is that judges are less subject to majoritarian pressures so that it is unlikely the clause was intended to apply to common law decisions. Obviously, neither rationale is wholly convincing. To the extent the first rationale is accepted, however, the same rule logically should apply where the legislature is simply defining common law concepts. For example, a court could construe the Minnesota statute involved in *Spannaus* as an attempt to define the obligation of good faith in the pension context. *See supra* note 93. The fact that a legislature rather than a court refuses to permit termination does not *require* a conclusion that there has been an impairment.

182. 438 U.S. at 258-59 (Brennan, J., dissenting).

ity rejected that interpretation on the basis of precedent and on the rationale that imposing an obligation necessarily takes away a right or reduces the obligation of the other party.[183] Brennan's argument is undoubtedly overstated,[184] but the majority's response is not entirely convincing. First, the precedent that the majority relied on either does not support the majority's position or does not directly address Brennan's argument.[185] Second, the majority's right/obligation argument is not necessarily valid. The Minnesota statute did not reduce the obligation of the Allied employees under the plan. They still had to satisfy all service and vesting requirements of the plan. The statute simply affected the timing of pension funding. It created a new obligation, it did not destroy or reduce one. Third, the statute does not fall within the contract clause's presumed historical purpose of prohibiting states from adopting debtor-relief laws.[186]

Spannaus is a hard case conceptually because the state pension statute affected the performance of the person that the statute burdened rather than the performance of the beneficiary. Allied's position was essentially no different from that of the bakers in *Lochner v. New York*[187] where the Court upheld a New York statute that limited working hours in bakeries. Status or past conduct, just like other regulatory statutes, determines the incidence of the pension statute. Yet, just because that status is contract-related does not bring it within the contract clause. Allied's right to terminate the plan still existed, it simply cost more to

183. *Id.* at 244 n.16.

184. *See* Schwartz, *supra* note 2, at 112-17.

185. Brennan relied on Satterlee v. Matthewson, 27 U.S. (2 Pet.) 380 (1829), which upheld a statute validating previously unrecognized landlord-tenant relationships on the ground that to create a contract could not possibly also impair that contract.

The majority cited two cases that are at least superficially contrary to Brennan's reading of *Satterlee*. Brennan argued that Detroit United Ry. v. Michigan, 242 U.S. 238 (1916), and Georgia Ry. & Power Co. v. Decatur, 262 U.S. 432 (1923), which involved disputes over the effects of annexation on transit contracts, were simply wrong. It is perhaps typical of the contract clause doctrine that the court could have decided both cases the same way on non-constitutional grounds because the contracts were subject to interpretation on the issue. More fundamentally, in each case the challenged statute did not simply impose an additional obligation; the claimants had been serving the territory before annexation and charging higher fares. In effect, the statute reduced the fare that each claimant earned for performing services it had been performing before. Thus, there was clearly a reduction in rights, but it does not necessarily follow that the addition of an obligation diminishes a right in all cases.

186. *See supra* notes 21-23 and accompanying text.

187. 198 U.S. 45 (1905). In *Lochner*, the Court held that a New York statute that limited employment in bakeries to sixty hours a week and ten hours a day violated the contract clause and could not be justified as a valid exercise of police power.

exercise.[188]

Spannaus demonstrates the futility of attempts to determine the proper role of the contract clause as a limitation on economic regulation by reference to formalistic distinctions like the right/obligation dichotomy.[189] A consideration of the original purposes of the clause offers a more promising means of determining the core policy of the clause. As indicated earlier, there are two general conceptions of the policy basis of the contract clause:[190] (1) Justice Brennan's view that the clause should be limited to class legislation such as debtor-relief measures;[191] and (2) Justice Black's view that the clause is intended to protect those who have relied on past laws in structuring their affairs.[192]

The first view is consistent with the Framers' interest in ensuring the growth of commerce among the states. Bargaining, rather than ownership, is the basis of commerce because commerce performs the essential function of allocating resources. Therefore, there may be good reason to single out contract rights instead of other property rights for special constitutional treatment. Trade and especially credit among the states would be greatly hampered if states could pass laws relieving their citizens of obligations. This would be an especially serious problem in those situations in which the creditor had already lent money or the seller had delivered goods. To avoid the risks of such legislation, lenders might refuse to deal except at higher interest rates or on a secured basis, and sellers might refuse to sell unless payment was made in advance or on delivery. Commerce would hardly flourish in such an atmosphere.[193] Thus, it seems clear that the contract clause, like the commerce clause, has a major macroeconomic thrust. Brennan's

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188. *See infra* note 328 and accompanying text. This is the essential import of the famous Holmes's aphorism.

189. The Court recognized in *Blaisdell* the inadequacy of the somewhat analogous right/remedy distinction that had been in vogue since the Marshall Court. *See supra* note 55 and accompanying text. The Court had never completely accepted the distinction. *See* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 287-89 (1827) (Johnson, J., concurring).

190. The lack of legislative history for the clause prevents any pretense that the following analysis is historically accurate. Rather, it is simply an effort to consider the implications of the two generally accepted purposes of the clause.

191. *See supra* notes 21-23 and accompanying text.

192. *See supra* note 25 and accompanying text.

193. The lender-seller's risk in this situation is entirely different from the usual credit risk related to the borrower-buyer's prospective inability or refusal to pay. Use of documentary drafts, letters of credit, and other devices can reduce those traditional risks. In contrast, even a letter of credit in favor of the seller would not eliminate the risk of impairing legislation.

view alone, however, does not explain the role of the clause. Debtor-relief legislation would have an adverse effect on commerce whether the legislation were in effect prospectively only or both retroactively and prospectively. Even prospective legislation would hinder commerce because creditor-sellers would be required to continually monitor other states' laws.[194]

Justice Black's view thus adds a crucial element. His view focuses less on macroeconomics than on the basic unfairness of upsetting an individual's affairs by changing rules on which the individual has relied. Hindrances to commerce from prospective changes may be necessary, but it is unfair to change the rules after a debtor has cashed a loan check or a buyer has received goods. In other words, only reliance makes a statute truly retroactive. If a seller finds out about a change in the buyer's rights before shipment, the seller can refuse to ship. Whether that refusal is "rightful" is irrelevant because the seller could have negotiated for the right to shift the risk.[195] Such a right is of no importance, however, once the goods are delivered because the seller is then at the buyer's mercy. After delivery, the seller's only protection is the contract clause.

Spannaus offers a good example of this point. The only reliance in that case could have been by the employees, who may have remained in Allied's employ or foregone other savings because of their reliance on the promise of a pension. Justice Stewart, however, claimed that Allied had "relied" on the lack of regulation.[196] Yet, reliance on *lack* of regulation should not be relevant for three reasons. First, it is difficult to determine reliance other than on the basis of self-serving testimony. Second, an absence of regulation today is perhaps the surest indication that government action is just around the corner. This principle is especially apparent in *Spannaus* because abuses in pensions have been widely publicized for years.[197] Indeed, the argument of a party contracting in a heav-

194. This was no easy task in the days of poor communication, and it is no easier today in the days of high legal fees. *Cf.* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 245-46 (1978).

195. An "Act of God" is a common contract provision that drafters of contracts use to protect parties when one party to the contract cannot perform a contractual duty due to factors outside the parties' control. *See, e.g.*, Uissho-Iwai Co. v. Occidental Crude Sales, Inc., 729 F.2d 1530 (5th Cir. 1984). By using such a provision, the parties may expressly allocate the risk of loss in the event of stipulated occurrences.

196. The record was clear "that Allied's actuarial assumptions in calculating its annual contributions to the pension plan did not include the possibility of a plant's closing." *Id.* at 253 n.2 (Brennan, J., dissenting).

197. *See, e.g.*, Bernstein, *Employee Pension Rights When Plants Shut Down: Problems*

ily regulated industry that it relied on a saturation of regulation is equally implausible.[198] Third, Allied's claim was not that it had taken action in reliance on the efficacy of the employees' obligations but that it had relied on its contractual right to terminate the plan, avoid liability, and retain its funds. Such reliance, however, is no different from the reliance of any property owner ordering his affairs on the basis of the resources over which he has command. The function of the contract clause should be to protect a party's reliance on performance of the contract and not merely on ownership of a contract right. The contract clause protects reliance on the right itself only when that right is in fact the "flip side" of the obligation that the legislation eliminated.

Four hypotheticals based on *Penn Central Transportation Co. v. New York*[199] illustrate this crucial distinction. In *Penn Central*, the Supreme Court rejected Penn Central's claim that New York's classification of Grand Central Terminal as a historical landmark constituted a taking because it prevented Penn Central from developing the property to its fullest potential. In the first hypothetical, assume that Penn Central purchased the terminal in 1935. In 1975 it decides to "develop" the property by building a fifty-story office building on top of it. In 1976, before construction has started, New York passes an ordinance prohibiting development. In 1976, Penn Central clearly had a "right" to develop, and this right could be termed a property right because Penn Central had an entitlement to so use the resources involved. But Penn Central did not *rely* on that right before New York passed the ordinance unless it had backed that expectation with an irreversible investment of resources.[200] It only had an "expectation" that it could develop the terminal.[201] The policy of the contract clause as outlined

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and Some Proposals, 76 HARV. L. REV. 952 (1963).

198. The regulation issue is also subject to the vagaries of labeling. *Cf.* Garris v. Hanover Ins. Co., 630 F.2d 1001 (4th Cir. 1980) (regulation of insurance for public protection versus regulation of relations between insurer and agents).

199. 438 U.S. 104 (1978).

200. Thus, it is not enough that a party has bargained for a right. *See supra* note 116. "Bargaining" is necessary for reliance but not sufficient to prove reliance.

201. *See* Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979). Justice Rehnquist found that the United States had taken Kaiser Aetna's property when it held that a passage from the ocean to Kuapa Pond was open to the public. With the consent of the government, and in connection with its development of a private marina, Kaiser had dredged the passage. Rehnquist used the opportunity to expound on the investment-backed expectation factor on which he had focused in *Penn Central*. Recognizing that Kaiser could not estop the Government from taking action, Rehnquist nevertheless recognized the fact that the Government authorized the dredging can "lead to the fruition of a number of expectancies em-

above suggests that only a reliance interest or "investment-backed expectation" is entitled to constitutional protection.[202]

This situation should be contrasted with a second hypothetical in which Penn Central contracts to purchase the terminal just prior to passage of the ordinance. Here there could be reliance on the development "right" if the price paid reflected the development potential. It does not necessarily follow, however, that every reliance interest should be constitutionally protected. One who purchases property for development assumes many risks, including cost overruns, a slowdown or decrease in demand for space, and construction of competing space. In a sense, government regulation is just another risk of ownership and such a risk may, as may the right to future development, be built into the purchase price.

The contract and taking clauses reduce the risk of retroactive government action, but there is little reason to protect the investor who should have anticipated government regulation. Therefore, even if Penn Central purchased the terminal with the expectation to develop it, its investment should be constitutionally protected only if (a) it has paid a premium for development and (b) regulation was not reasonably foreseeable. Only when such "reliance" can be shown would the hardship that specific legislation causes be sufficient to bring the taking or the contract clause into effect.[203] Oth-

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bodied in the concept of 'property'—expectancies that, if sufficiently important, the Government must condemn and pay for before it takes over the management of the landowner's property." *Id.* at 179.

Although *Kaiser* was a case of actual physical invasion rather than mere regulation, the analysis of protected interests should be the same; any difference in analysis would relate to the degree of interference that is permitted with respect to those expectancies. For present purposes, it must be stressed that Justice Rehnquist has not delineated the boundaries of an investment-backed expectation factor. *Kaiser* was an easy case where the investment and reliance were obvious. The hypotheticals discussed in this Article are intended to investigate what precisely "investment" means and what is necessary to make such expectations "legitimate." *Cf.* Pruneyard Shopping Center v. Robins, 447 U.S. 74, 84 (1980) (requiring shopping center owners to allow nonowners to exercise their freedom of expression through petitions is not a "taking" under the fifth amendment).

202. The Court in Board of Regents v. Roth, 408 U.S. 564, 571 (1972), recognized the importance of reliance: "It is a purpose of the ancient institution of property to protect those claims upon which people rely in their daily lives, reliance that must not be arbitrarily undermined." *Id.* Professor Michelman places much less emphasis on the importance of reliance in determining the scope of property rights that the Constitution protects. *See* Michelman, *Property as a Constitutional Right*, 38 WASH. & LEE L. REV. 1097, 1102 (1981). Michelman's focus, however, is on expanding the concept of property to protect political and personal rights. *Cf.* United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166 (1980) (Brennan, J., dissenting) (breach of a prior government commitment concerning railroad workers' retirement benefits frustrated their legitimate expectations).

203. The second hypothetical presents no contract clause issue because the seller has completely executed the contract involving the purchase of the property. As the purchase

erwise, there is insufficient reason to believe that the risk of government action differs from other risks.

In the third hypothetical, assume Penn Central bought the terminal before the passage of the 1976 ordinance, under an installment land sale contract that gave Penn Central the "right" to develop the property and place liens on it superior to the seller's interest. This case is similar to *Spannaus*—there is a contract, and legislation colorably affects a contract right. It should not matter whether the ordinance prohibits development or simply makes it more expensive. Either way, it interferes with Penn Central's contract right. Penn Central, however, does not have a contract clause claim because the statute does not affect the seller's obligation at all. On the other hand, if Penn Central had already begun development or if Penn Central had agreed to pay the seller a premium for the development option at a time when government was not reasonably foreseeable.

The fourth hypothetical presents another "false" contract clause problem. Assume Penn Central purchased the terminal on the basis of an agreement that it would develop the terminal and pay the seller a percentage of the rents received from the fifty-story building. Later, the state legislature passes an ordinance prohibiting development, and the seller seeks a declaration that the ordinance is invalid because it impairs Penn Central's rental obligation. The seller should lose. Although there is no doubt that the ordinance "impaired" the seller's right, the contract clause did not protect the seller's right. The ordinance did not, by its terms or effect, reduce the obligation of Penn Central to pay rent for the existing structure. The ordinance merely eliminated the seller's (and Penn Central's) *expectation* that, if the development occurred, a higher rent would be paid. Such legislation did not affect any reliance interest of the seller; presumably he will receive the same value for the "undeveloped" property from Penn Central as he would have received from any other party. But even if he does not, that is a risk against which he could have protected himself at the time he negotiated the sale contract with Penn Central.

It is only when a party cannot protect himself by contract from the adverse government action that a constitutionally protected contract right may be affected. In the fourth hypothetical, the seller was in the same position after passage of the ordinance

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price did not include a premium to insure the possibility of future development, Penn Central got all it bargained for from the seller.

as he would have been if he had not sold the property. His return on his investment in the property has been reduced only because development is no longer possible, not because the ordinance relieved Penn Central of the obligation to pay for development-generated benefits. Compare this case to the classic debtor-relief measure; the creditor's old property (the money lent) is as valuable or even more valuable after the passage of the ordinance as it was before, but the value of the debtor's promise has been reduced. In the fourth hypothetical, what Penn Central received is reduced in value; thus there is no unjust or unfair enrichment of the other party to the contract.

In summary, the contract clause does not and should not protect all contract rights from impairment. Courts should narrowly interpret the clause because it interferes with legislative efforts to meet the needs of a changing society. The Court's failure to identify the precise nature of the property interest that the clause protects has led to decisions that interpret the clause more broadly than its policy underpinnings justify. Perhaps more importantly, this has led to confusing opinions and undue reliance on the police power doctrine.[204] Fortunately, there is still ample opportunity for the Court to incorporate a reliance analysis into its restructuring of the contract clause.

V. RECONCILING THE CONTRACT CLAUSE WITH THE TAKING CLAUSE

Both Justice Blackmun and Justice Brennan recognized in *United States Trust* that New Jersey could have accomplished its objective by "condemning" the bondholder's interest in the 1962 covenant and agreed that condemnation would have eliminated the bondholders' contract clause claim.[205] Application of the taking clause would be preferable in most cases to reliance on the contract clause because the former both permits the state to accomplish its public purpose and protects the contractual rights of the contrac-

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204. A good example is Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400 (1983).

205. *United States Trust*, 431 U.S. at 19 n.16, 42 n.11. Query to what extent inverse condemnation would be available in *United States Trust* after *Pruneyard*. Pruneyard Shopping Center v. Robins, 447 U.S. 74 (1980) ("literal taking" of right to exclude persons from shopping center not a "constitutional taking"). *See supra* notes 164 & 201. To a great extent, the Court's recent problems in deciding "regulatory taking" cases presents substantial problems beyond the scope of this Article. *See generally Symposium: Constitutional Issue in Land Use Regulation*, 8 HASTINGS CONST. L.Q. 449 (1981) (exploring such questions as the proper remedy for inverse condemnation actions).

tor.[206] In those situations in which a statute both "takes" and "impairs," use of the taking clause would seem to be a less desirable alternative than the contract clause only where the nature or value of the contract right "taken" would be speculative.[207] The situation can be compared to that of the availability of specific performance for breach of contract. The aggrieved party may desire to obtain specific performance rather than damages, but she can only do so if damages would be speculative or inadequate.[208]

The same rule should apply in contract clause cases. That is, where a state or a local government interferes with contractual rights, the contractor should be limited to an inverse condemnation action unless a taking has not occurred or just compensation cannot be measured. The justification for this proposal is not merely a desire for symmetry between contract law and constitutional law. The justification is that the same policies support the

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206. A compensation award protects the contractor's rights because a contract does not give a party a legal right to performance but only a right to damages if the other party does not perform a contractual duty. *See* Hale, *supra* note 5, at 518. For the view that use of eminent domain is particularly appropriate in the context of public contracts, see Sax, *Takings and the Police Power*, 74 YALE L.J. 36 (1964). Professor Sax has somewhat modified the views expressed in his 1964 article with respect to the manner in which property rights are defined and analyzed. In a 1971 article, he focused on whether there is a conflict in "rights" between property owners in the sense that a use by one interferes with a use of property by another. Only when these "spillover" effects are present can the government regulate without triggering the taking clause. Sax, *Takings, Private Property and Public Rights*, 81 YALE L.J. 149 (1971).

207. The taking clause may not apply to all "impairments" because of the Supreme Court's ad hoc decision-making as to what constitutes a "taking." *See supra* note 205; *see also* Freilich, *Solving the Taking Equation: Making the Whole Equal the Sum of the Parts*, 15 URB. LAW. 447 (1983) (explores the constitutional analysis and doctrinal suport for the basic rule of Justice Brennan's dissent in San Diego Gas & Electric Co. v. City of San Diego, 450 U.S. 621 (1981)); Mandelker, *Land Use Takings: the Compensation Issue*, 8 HASTINGS CONST. L.Q. 491 (1981) (examines the compensation issue in land use regulation and determines that there has never been an absolute right to compensation, even where an interference with property rights is sufficient to constitute a taking); *cf.* Penn Cent. Transp. Co. v. New York, 438 U.S. 104 (1978). This problem, however, could be eliminated if the approach urged in 1964 by Sax were combined with the approach urged here. *See supra* note 206. In essence, Sax argued that a taking should be found whenever a government is acting as an "enterprise" or a "mediator." Although Sax has modified his views, he still recognizes an "equal protection" aspect to compensation law that prohibits an arbitrary or discriminating decision as to who is to bear the risk of loss in the event of government action. *See supra* note 206. Moreover, he is particularly aware of the problems involved when the government acts in its own self interest. *See* Sax, *Takings and the Police Power*, 74 YALE L.J. 36, 60, 63 (1964). Sax notes that "the protection afforded [by the taking clause] is most properly viewed as a guarantee against unfair or arbitrary government," and that "when economic loss is incurred as a result of government enhancement of its own resource position . . . then compensation is constitutionally required." *Id.* at 60, 63.

208. *See* RESTATEMENT (SECOND) OF CONTRACTS § 359 (1979).

same rule in both areas. A court will not enforce a statute that is found to violate the contract clause. Imposition of the clause preserves the status quo and prevents the government from dealing with what presumably is a legitimate concern. Such a significant interference with the legislative process should occur only when necessary. Allowing a contract clause claim where an inverse condemnation action is available wastes resources and is unnecessary to protect the rights of the claimant. It wastes public resources because, as Justices Black and Brennan have recognized, enjoining enforcement under the contract clause does not prevent the government from later condemning the affected right. If the government really cares about the issue, the only result of a successful contract clause action is a later eminent domain proceeding. Such a proceeding is a waste of judicial, legislative, executive, and private resources.

Allowing the contract clause claim where a taking claim is available is unnecessary because the essence of the property interest that a contract right represents, as a matter of contract law, is simply the right to be placed in the economic position that would have resulted from performance.[209] State contract law is directly relevant here; there is no basis in the history of the clause for a conclusion that the clause protects anything other than derivative rights.[210] Indeed, contract clause protection is narrower in scope than the protection that state contract law affords to contract rights because the former should protect only reliance interests, whereas state contract law generally protects both reliance and expectation interests. There can be no justification for giving a claimant greater rights under the Constitution than he enjoys under the law creating his property interest. Yet, that would be the case if a claimant could obtain constitutional specific performance even where inverse condemnation damages are adequate.

The inverse condemnation action should be required only where an award of damages would in fact be just compensation for interference with or deprivation of the contract right.[211] In the vast

209. Fuller & Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 373 (1936-1937).

210. Nor does there seem to be a strong justification for extending the clause beyond its historical purposes. The clause does not rank with due process or equal protection as a fundamental concept of ordered liberty. Thus, the Michelman argument for expansion of the property concept to protect political and personal rights is not persuasive here. *See* Michelman, *supra* note 202.

211. Of course, the claimant could combine his contract clause and inverse condemnation actions in one suit.

majority of contract right cases, as in tangible property cases, it is possible to measure monetarily the value of the right taken. The fact that it is difficult to determine the amount of the award should not mean that a court cannot determine just compensation in all cases.

United States Trust illustrates the problems that a judicial calculation of an award presents. Justice Blackmun did not find it necessary to consider the value of the right taken or impaired.[212] On the other hand, Justice Brennan believed that the covenant was of little or no value to the bondholders.[213] Brennan's view was based on the findings of the trial court that the obligation of the Port Authority to the bondholders to pay principal and interest had not been affected nor had the repeal of the covenant substantially reduced the value of the revenues pledged to the bondholders.[214] Justice Brennan's analysis, however, is unacceptable. Virtually any covenant, other than a promise to pay or the giving of collateral *per se* would be subject to the same attack. In the typical financing situation, such as that before the Court in *United States Trust*, it is extremely difficult to attribute to the various restrictive covenants separate monetary values as of the date of the taking. However, those experienced in pricing or evaluating financial instruments, such as investment bankers, rating services and institutional investors, should be able to estimate the difference in the interest rate that puts the lender in the same position as if the restrictive covenant had not been included. Unless some event has occurred during the period between the original loan and the taking, one could reasonably presume that the differential has remained constant. Of course, if the right taken was simply "belt and suspenders" protection that gave no real benefit to the lender, Brennan's viewpoint would be correct. Despite the trial court's findings in *United States Trust*, the covenant did appear to have a tangible value.[215]

Of course, the just compensation awarded in an inverse condemnation action need not be monetary. There appears to be no reason why a court could not compensate a party whose contract right had been taken by substituting a right of equivalent value.[216]

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212. *United States Trust*, 431 U.S. at 19.

213. *Id.* at 42 n.11 (Brennan, J., dissenting).

214. *Id.* at 41-43.

215. *Id.* at 18-19.

216. Penn Cent. Transp. Co. v. New York, 438 U.S. 104, 137 (1978), involved the issuance of transfer development rights (TDRs) to owners whose development rights had been

In *United States Trust*, instead of awarding the bondholders damages for the taking, with a commensurate credit to the Authority on the amount due on the bonds, the Court could have given the bondholders a similar negative pledge on other funds, a mortgage on other property, or even a right to demand payment on an accelerated basis if the commuter project did in fact drain the Authority's funds. Thus, even though the evaluation problems involved in nonmonetary compensation are difficult, a substitution of rights would not place an undue strain on the public entity's resources.[217]

Justice Blackmun's response to this suggestion would apparently have been that the legislature has the burden of making these determinations, and it cannot shift that burden to the other contracting party or to the courts. The courts should, however, decide the taking and compensation issues first. Although in some cases the State legislatures may have adopted the legislation simply to avoid paying for the contract right, in most cases, it is more likely that the legislature reasonably determined that the legislation was constitutional as applied to the specific right at issue or it may not have been aware of the legislation's effect on the right. It insults the notion of judicial economy for a court to merely declare the legislation unconstitutional under the contract clause without making a threshold determination as to just compensation for an inverse condemnation, because the case will be right back in the courts the next time the legislature tries to circumvent paying for a contract right through legislation. Second, the challenged legislation may be the result of compromises between the government and the claimant. In other words, it may in fact be the claimant who is seeking to shift the burden of determining compensation to the courts.

If a court reaches the contract clause claim only when an inverse condemnation award would not restore the claimant to the status quo, contract clause claims should be limited to two types of

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"taken." The Court considered the TDRs to be relevant to the taking question. Even if TDRs do not constitute just compensation for a taking, a court must take them into account in considering the impact of a statute on the owner. TDRs may mitigate a statute's infringement on an owner's property right. Inherent in such an analysis is the assumption that a regulatory taking is fundamentally different from a *Teleprompter* taking (permanent occupation or destruction of real estate). *See supra* text accompanying note 172. For a regulatory taking, the fifth amendment requires not "just" compensation, but minimal, nonconfiscatory compensation. The better view would be to analyze TDRs as relevant only to the compensation issue because it is the degree and type of effect on the interest in the property that the regulation affects that is the heart of the taking or impairment question.

217. Congress has implemented a comparable approach in the Bankruptcy Reform Act of 1978. *See* 11 U.S.C. §§ 361-363, 1129.

cases. The first is the presumably narrow class of cases where just compensation cannot be determined. As discussed above, there should be few claims in this group because courts should be able to adjust the remaining contractual relationships whether the contract is public or private. The second group, a potentially larger class, consists of those cases in which there has not been a taking.[218] Most statutes that "impair" will also "take" because of the similarity of the interests that the two clauses protect. Thus, a statute that reduces the efficiency of the other party's performance will probably constitute both an impairment and a taking. A statute that only imposes an additional obligation on a party, however, probably will not constitute a taking, but it may constitute an impairment, especially in the public contract context. In short, the requirement that an inverse condemnation claim be determined before a contract clause claim does not write the contract clause out of the Constitution. The requirement would simply reduce unnecessary judicial interference with legislative goals and would eliminate the potential for wasteful and circuitous impairment versus condemnation litigation scenarios.[219]

One obvious obstacle to effective use of the taking clause as a prerequisite to use of the contract clause is the Supreme Court's recent confusion in determining whether a "taking" has occurred.[220] By deciding inverse condemnation cases on an *ad hoc*

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218. A discussion of the law of "taking" without due process of law under the fourteenth amendment is beyond the scope of this Article.

219. Such a rule would be consistent with Hays v. Seattle, 251 U.S. 233 (1920). Hays had a contract with the state to excavate a waterway. After a dispute arose between the parties, the state transferred the land to the Port of Seattle. The act transferring title did not by its terms affect Hays's right to payment under the contract or his lien on the land. The Court held that legislation that merely breaches an agreement with a public entity does not give rise to a claim under the contract clause. Instead, the contractor is limited to an action for breach of the contract.

The *Hays* rule frequently will provide the same result in public contract cases as would the taking clause. In other cases, however, resort to the taking clause will be necessary. For example, legislation that prevents an action on a public contract or that imposes additional obligations on the contractor generally will not be comparable to a breach of the contract by the government unless a court could construe the legislation as a repudiation.

220. *See supra* note 205. Another problem that may arise in the context of public project agreements is that the government party to the contract may not have eminent domain power. In such a case, the courts have held that the contractor cannot bring an inverse condemnation action. *See, e.g.*, Jacobson v. Tahoe Regional Planning Agency, 566 F.2d 1353, 1358 (9th Cir. 1977); Note, *Inverse Condemnation: Its Availability in Challenging the Validity of a Zoning Ordinance*, 26 STAN. L. REV. 1439, 1450-51 (1974).

Professor Cunningham believes that a § 1983 damage action should be available:

> It is now settled that municipalities and other local government units are "persons" and may therefore be liable under section 1983, that the good faith of local

basis, the Court has given little guidance to lower courts. There is reason to believe, however, that the "taking" problem will be less substantial in contract clause cases because the bundle of rights present in contract claims are more defined than the bundle of rights present in typical land use cases. Courts have a great deal more experience in interpreting contracts and determining the parties' relative rights than they have in identifying the nature and extent of rights in real property.[221] The "legal" nature of contract rights and their inseparability from the question of remedy makes them more appropriate for judicial definition. Moreover, contract rights must be reasonably definite to be enforceable under state law. The courts, therefore, should not be faced with the quasi-philisophical problems that have perplexed those dealing with alleged takings of "stick" interests from a tangible property bundle.

Another obstacle to adoption of this proposal is the argument that damages are not an appropriate remedy for a regulatory taking. In *San Diego Gas & Electric Co. v. San Diego*,[222] the Supreme Court refused to reach this issue because it determined that the state court judgment was not "final." Justice Brennan in dissent, however, reached the merits and found that the states are constitutionally required to award damages for an uncompensated regulatory taking.[223] Because three other Justices joined the dissent and Justice Rehnquist indicated[224] that he agreed with Justice Brennan

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> government officials whose actions deprive a "person" of federal constitutional or statutory rights does not immunize the local government from such liability, and that there is a cause of action under section 1983 when one is deprived of property without due process of law.

Cunningham, *Inverse Condemnation as a Remedy for Regulatory Takings*, 8 HASTINGS CONST. L.Q. 517, 541 (1981) (footnotes omitted); *see also* Mandelker, *supra* note 207 (If a party is unable to bring an action for damages, he may nonetheless attack the legislation under the contract clause.).

Another problem with using the taking clause is judicial assessment of the value of the property taken. If a monetary award is not appropriate, a court should be able to fashion a substitute right. *See* Kraft, Loikith & Petkanics, *Accommodating the Rights of Bondholders and State Public Purposes: Beyond United States Trust*, 55 TUL. L. REV. 735, 769-70 (1981).

221. Professor Michelman has concluded that courts do a satisfactory job of balancing the competing interests in taking cases. Michelman, *Property, Utility and Fairness: Comments on the Ethical Foundation of 'Just Compensation' Law*, 80 HARV. L. REV. 1165, 1169 (1967).

222. 450 U.S. 621, 630 (1981).

223. *Id.* at 653-58 (Brennan, J., dissenting). Under Brennan's view, a court need not award damages in the full amount of the property's value. The government has the option of rescinding the statute or regulation and paying damages only for loss of use during the interim. *Id.* at 653.

224. *Id.* at 633-34, 636.

on the merits, it appears that damages will be available.[225] Some commentators point out that Justice Brennan's conclusions lack a constitutional basis. None of the United States Supreme Court cases on which Justice Brennan relied held that the fourteenth amendment requires that compensation be awarded to a landowner whenever the Court finds that a regulatory taking has occurred.[226]

Even if the view that damages should not be awarded in land use regulation cases does prevail, inverse condemnation should still be available in disputes over *public* contract rights. A legislature or a responsible administrative agency should be able to determine the number of public contracts that legislation has affected and the impact of legislation on the contractor's rights. These considerations eliminate much of the force of the arguments supporting the restriction of remedies in land use planning cases, which generally involve larger numbers of landowners and ill-defined taking issues.

VI. THE MEANING OF IMPAIRMENT

A. *The Initial Inquiry: Has the Contract Been Modified?*

The Supreme Court held in the early 19th century that any law that modifies a contract constitutes an impairment of the constitutional right to contract.[227] The Court, however, has established in *Blaisdell*, *El Paso*, and *Exxon* that not every modification of a contractual obligation or right is an impairment. Unfortunately, the Court has given very little guidance on how to analyze the issue and determine whether a modification is an impairment.

The Court has established several rules of "construction" regarding modification. First, state law determines whether a modification or impairment has occurred;[228] however, federal courts are to make their own determination of what obligations state law creates.[229] Secondly, courts are to construe public contracts strictly in

225. *See, e.g.*, Hernandez v. Lafayette, 643 F.2d 1188, 1198-99 (5th Cir. 1981). The *Hernandez* court based its decision on the reasoning Justice Brennan provided in his dissent in San Diego Gas & Elec. Co. v. San Diego, 450 U.S. 621, 658-59 (1981) (Brennan, J., dissenting).

226. Cunningham, *supra* note 220, at 538.

227. *See* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827); Hale, *supra* note 5, at 871.

228. Coolidge v. Long, 282 U.S. 582 (1931); Appleby v. New York, 271 U.S. 364, 380 (1926); Hale, *supra* note 5, at 852-60.

229. Irving Trust Co. v. Day, 314 U.S. 556, 561 (1942); Appleby v. New York, 271 U.S. 364, 380 (1926); *cf.* Phelps v. Board of Educ., 300 U.S. 319, 322 (1937) (weight will be given to the construction of the statute by the courts of the state). Further, although the Supreme Court may follow state law existing prior to the contract, it may not accept the state court's

favor of the state and resolve every ambiguity against the contractor.[230] After *Energy Reserves* and *Exxon*, one could argue that all contracts are to be strictly construed against the claimant.[231] Finally, in the public contract arena, a court must distinguish a modification or impairment from a breach. If legislative action breaches a contract but does not modify the contractor's obligations or remedies, a constitutional issue is not raised.[232]

The application of these rules frequently will dispose of a contention that legislation has modified a contract, but most cases will require that a court determine the precise nature of the parties' bargain. The mere fact that legislation has affected a contractor's method of performance does not mean that it has modified the contract. For example, in *Atlantic Coast Line Railroad v. Goldsboro*,[233] the railroad claimed that city ordinances regulating the right to use its tracks violated its right of way contract with the state. No mention was made in the charter that the railroad was exempt from city ordinances, so the rule of strict construction provided a ready answer to the railroad's claim.[234] The railroad no longer had unlimited use of the right of way that it had enjoyed in the past, but the new restrictions did not limit any right that the parties expressly bargained for in the railroad's charter. In a sense, the ordinances did not modify the respective rights or obligations bargained for and created by the contract but merely the consequential benefits flowing from the rights granted therein.

Of course, legislation may constitute a modification even though the right it affects is not explicit in the contract. For exam-

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present understanding of previous decisions construing state law. For a detailed discussion of the decisions on this issue, see Hale, *supra* note 5, at 852-71.

230. Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 420 (1837); *see* SCHWARTZ, *supra* note 5, at 279-83.

231. *See supra* note 152.

232. *See supra* note 219. Although this rule appears settled, its application is unclear. A good example of the uncertainty in this area is Jackson Sawmill Co. v. United States, 580 F.2d 302 (8th Cir. 1978), *cert. denied*, 439 U.S. 1070 (1979). There, the federal court found that the statute in question merely breached the contract; and it dismissed the contractor's constitutional claim, which required the contractor to bring its claim for breach of contract in state court. Unfortunately, because of the eleventh amendment immunity, the contractor could not bring a suit for breach of contract against the state in federal court at the same time that he brought a contract claim. *Id.* at 309-10. In other words, rather than risking statute of limitation problems, a plaintiff should bring both his breach of contract and contract clause actions together in state court when it is unclear whether legislation merely breaches a contract or impairs a contract's obligation.

233. 232 U.S. 548 (1914).

234. The Court, however, decided the case under the police power doctrine rather than the rule of strict construction.

ple, *E & E Hauling, Inc. v. Forest Preserve District*[235] involved an ordinance prohibiting the plaintiff from using liquid wastes to complete the landfill project the plaintiff had contracted with the defendant to construct. The Seventh Circuit recognized that the trial court would be required to determine whether the parties contemplated the use of liquid waste, even though it was not expressly addressed in the contract.[236] The Court, if confronted with the issue, should adopt the same approach.

Issues of interpretation may be presented even if the legislation deals with a subject the contract explicitly covered. In *Puerto Rico v. Russell & Co.*,[237] an irrigation district had contracted with a landowner whose property was located outside the district to deliver water free of charge in exchange for the landowner foregoing his riparian rights. Under the contract, the landowner was also entitled to a portion of any surplus water supply. When the landowner objected to the district's failure to deliver the surplus, the district enacted a statute that empowered it to impose a tax on landowners who received water but whose lands were not in the district. The Court viewed the tax as a charge for water that was explicitly outside the scope of the contract and held that it violated a provision of the Puerto Rican constitution prohibiting the impairment of contracts.[238]

Unfortunately, in cases such as *United States Trust* and *Energy Reserves*, the Court reached a decision with little attention to the record or without adequate explanation. Project agreements with public entities, which generally involve more negotiation and documentation than government procurement contracts, offer a good example of the difficulties the modification issue can present. For example, a project agreement for a waste treatment plant may require the builder to satisfy certain pollution control standards. If the local government later adopts ordinances that change the pollution standards, the issue would arise as to whether imposition of the new standards modify the contract. Both sides would undoubtedly rely on the fact that the project agreement included a "merger clause," which provides that the written agreement contains all understandings between the parties and that no additional obligations will be implied against either party with respect to the sub-

235. 613 F.2d 675 (7th Cir. 1980).
236. *Id.* at 678 n.4.
237. 315 U.S. 610 (1942).
238. *Id.* at 616-19.

jects dealt with in the agreement.[239] The government would argue that the merger clause prohibits the contractor from claiming that the government implicitly agreed not to impose additional or more burdensome controls. The contractor would argue that the merger clause prohibits the government from, in effect, implying a covenant that it could change the standards the agreement imposes. These arguments become more complicated if the agreements include, as they usually do, a clause providing that the government is free to adopt legislation to protect the public safety, health, and morals, as an exercise of its police power. Because the merger clause and the police power clause are really boilerplate provisions and therefore not likely to be individually negotiated, a court is faced with the problem of interpreting the precise intent of the parties at the time they negotiated the contract, with respect to the government's right to impose additional burdens on the contractor. For example, the parties could have anticipated implicitly that differing standards would not be imposed upon the contractor in the absence of unforeseen developments. Therefore, a newly-elected legislative body that adopts different, but not necessarily better, standards of general application could be held to have modified the agreement, even though the written agreement expressly permits the government to adopt police power ordinances.

A court can best resolve these problems by ignoring the fact that one party is governmental. Too frequently, a court's discussion of the modification issues includes references to the scope of the police power and other issues that are more relevant to the ultimate constitutionality than they are to the impairment of the contract. Courts should determine the modification question solely by application of principles governing the interpretation of contracts, including the parol evidence rule and similar doctrines.[240] The parol evidence rule is especially important in interpreting contracts that include police power and government *force majeure* clauses.[241] Because such clauses are so broadly worded and yet seldom negotiated, a court will often be required to rely on parol evidence as to what meaning, if any, the parties gave to the contract language.

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239. In less formal contracts that do not include a merger clause, state law regarding the implication of covenants may preclude an argument by the contractor that the state implicitly agreed not to impose different standards.

240. *Cf.* U.C.C. § 2-202 (parol evidence rule relevant to contracts involving the purchase and sale of goods).

241. *See supra* note 195.

B. *When is a Modification an Impairment?*

Whether a modification always constitutes an "impairment" is a difficult issue simply because the Court's decisions on this issue are confusing. In *United States Trust*, the Court first quoted *Blaisdell* and *El Paso* to the effect that not every modification of an obligation is an impairment. The Court then found a "technical" impairment and determined whether that impairment violated the contract clause.[242] *Spannaus* represents a different approach. There, Justice Stewart determined whether a substantial impairment existed and then measured the significance of the impairment against the importance of the public purpose of the impairing legislation.[243] In *Energy Reserves*, the Court adopted the *Spannaus* approach, but it also cited *United States Trust* on the impairment issue.[244]

By reading these Burger Court decisions together, one may establish a three-step approach to determine whether a statute violates the contract clause. First, is there a modification? If so, does such modification constitute an impairment? Lastly, is it an unconstitutional impairment? Such an analysis is not necessary. Rather, the question should be whether the modification that the legislation imposes simply breaches the contract like any other unilateral attempt to modify an agreement, or whether the statute prevents or materially limits the contractor's ability to enforce his contractual rights. For example, legislation impairs a public contract only if it prevents or materially limits the remedies that would be available if the contract were between private parties.[245] In the case of private contracts, legislation that "permits" one party to breach may make breach more likely to occur, but it does not constitute an impairment unless it also precludes the other party from obtaining redress in court.[246] Because recourse to the legal system is the essence of a contract right, impairment requires not merely interference with the contract that results in a breach but interference with the *remedies* for breach. Defining "impairment" as an act permitting or requiring breach would subject virtually all economic legislation to attack under the contract clause. Certainly, the Framers could not have intended the clause to have

242. *See supra* text accompanying notes 78-79.

243. *See supra* text accompanying notes 95-97.

244. *Energy Reserves*, 103 S. Ct. at 704-05.

245. *See supra* note 219.

246. *Cf.* New Brunswick v. Milltown, 686 F.2d 120, 134-35 (3rd Cir. 1982) (involving federal agency and municipal corporation).

such broad application.

C. *Impairment in the Absence of Modification*

It is not as obvious that a taking has occurred when legislation imposes an additional obligation upon a party to a contract, as it is when legislation has deprived a party of a right or relieved the other party of an obligation. In *Spannaus*, the Court held that the imposition of an additional obligation can constitute an impairment under the contract clause, but it is more difficult to see how an imposition of an additional obligation can constitute a taking where the obligation does not result in a destruction or invasion of tangible property. The mere imposition of an additional obligation will undoubtedly result in a monetary loss to a contracting party, but courts have seldom held that such a loss would constitute a "taking" because virtually any legislation may be attacked on that ground.[247]

In many public contract situations, legislation imposing additional obligations on the contractor may simply constitute a breach. If the contractor refuses to comply with the additional obligation, the government can either withhold payment or terminate the contract. In either circumstance, the contractor can sue for the breach. The legislation is nothing more than an unjustified demand by a party for additional benefits. Usually, however, a court will interpret the legislation as foreclosing the remedy for breach of contract. For example, a court may determine that a statute requiring different pollution control equipment on a public project after the contractor has installed conforming equipment precludes a lawsuit by the contractor under contract law or other state law. Such an interpretation would make the statute a true impairment because it neither breaches the contract nor nullifies a contract right, and yet it deprives the contractor of a protected reliance interest. In other words, where the contractor has performed or commenced performance so that his right to payment is a protected

247. *See supra* text accompanying notes 239-40 (public project agreement example). Minimum wage legislation is a good example. *See* West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937). Such a statute increases the cost of doing business in the future and is therefore primarily prospective in application. But it also has retroactive effects, both as to existing employment agreements (that are probably insignificant) and the return the employers originally expected from its investment in a plant and equipment. This view demonstrates again the importance of adequately defining the interest protected. *See supra* notes 199-203 and accompanying text; *cf.* Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1976) ("retroactive" black lung compensation program upheld).

reliance interest, the statute has "impaired" an "obligation of contract" and is therefore within the scope of the contract clause. It does not, however, follow that the statute is unconstitutional.

It has been settled since *Blaisdell* that the proscription of the contract clause is not absolute. Courts are now required to balance the contractor's interest, which the contract clause protects, against the public interest, which the police power protects. Analogizing the contract clause to a decree for an injunction of specific performance under contract law, the last element of this analysis is the balancing of public versus private interest that is a part of every equity court decision.

VII. Giving Effect to the Public Interest

A. *The Proper Scope of Judicial Review*

The analysis to this point has led to the conclusion that courts should invoke the contract clause only if legislation adversely affects a claimant's contractual reliance interest in a manner that deprives the claimant of effective redress under both state law and the taking clause. At this point it is appropriate to ask the question: What is the consequence of a finding that a statute impairs an obligation within the meaning of the contract clause?

Even though one or all interest groups may have contractual interests that might be harmed, any interpretation of the meaning of the contract clause should to some extent permit a state to cope with unavoidable conflicts in rights. The Court, however, has failed to delineate the balance of powers between the judiciary and the legislature in this area.[248] It is a premise of this Article that significant judicial review of legislative determinations under the contract clause is both appropriate and consistent with constitutional law in general.

One of Justice Brennan's primary criticisms of the stricter standard of review that *United States Trust* imposed was that it equated the protection given to property rights with that given "personal" rights.[249] Such criticism is not well-founded. The distinction between "personal" and "property" rights, although seemingly a clear one at the polar extremes, ignores the fundamental

248. Professor Schwartz has interpreted *United States Trust* as requiring the same strict scrutiny in cases involving economic rights as is required in cases involving fundamental interests. Schwartz, *supra* note 2, at 118.

249. *United States Trust*, 431 U.S. at 60-61 (Brennan, J., dissenting).

relationship between economic rights and liberty.[250] A system of review dependent upon labeling alone is incapable of fully evaluating the real interests at stake in cases like *United States Trust*. To say that mere property rights were involved incorrectly assumes that none of the bondholders, including beneficiaries of trusts that institutions like U.S. Trust administered, were dependent on the expected return for the necessities of life.[251]

It has been argued that the clause is merely a limitation on the means available for states to achieve otherwise legitimate ends. Not only can the states not abolish contracts in general, they cannot act with malice toward, or in disregard of, contractual rights.[252] A court's approach in response to such an argument would focus on whether the effect on contracts was incidental or primary or, perhaps, on whether the legislature intended to harm contractual interests. The *Blaisdell* court rejected the primary versus incidental labeling of effects;[253] although legislative intent should be a factor in contract clause analysis,[254] two considerations mandate that it not be the sole element. First, such a narrow analysis would ignore the antimajoritarian basis of the clause and the role contracts play in the growth of commerce. Even benign impairment violates the clause's underlying policy. Secondly, a narrow interpretation of "legislative malice" would permit pure-hearted but empty-headed legislatures to blithely nullify reliance interests to promote even the most dubious "public" benefits. Regardless of the nature of the contractual interest involved, a broad interpretation of the concept would give contract claims an arbitrary preference over noncontract claims.

Such a minimal scrutiny or motive test would be merely a variant of the due process rational basis test. Any standard of review will be reduced to a rubber stamp if consideration is given only to the purported benefits of the regulation—whether the purported legitimate state interest really is legitimate.[255] Acceptance of the

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250. *See* McCloskey, *Economic Due Process and the Supreme Court: An Exhumation and Reburial*, 1962 SUP. CT. REV. 34, 45-50 (1962); Schwartz, *supra* note 2, at 119-21.

251. The fallacy of the distinction between personal and property rights becomes more dangerous as the growth of pension funds and direct access to capital markets makes many more "consumers" direct investors.

252. *See United States Trust*, 431 U.S. at 56-59 (Brennan, J., dissenting); Note, *A Process-Oriented Approach to the Contract Clause*, 89 YALE L.J. 1623 (1980).

253. *See supra* note 155.

254. *See infra* notes 317-21 and accompanying text.

255. Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1976), for example, negates any claim that the rational basis test in fact requires a balancing test.

premise that meaningful judicial review is appropriate suggests that the benefits of the legislation should be balanced against the harm that the affected contractual interests will suffer. Indeed, since *Blaisdell*, the Court has recognized either explicitly or implicitly the need for balancing. However, it has yet to develop a consistent approach. Under *Spannaus*, a court must carefully examine the nature and purpose of the legislation to determine if it justifies an impairment. This is a more strict version of the balancing approach than that which the Court implicitly adopted in *Blaisdell* and *El Paso* but explicitly rejected in *United States Trust. Energy Reserves* and *Exxon* have apparently relaxed the *Spannaus* standard and reverted to the *El Paso* approach. The reason that the Court has been unable to develop a proper balancing test is that it has relied on the police power doctrine to reconcile the need to protect the public interest with the directive of the contract clause.[256]

B. *The Inadequacies of the Police Power Doctrine*

An understanding of the origins and rise of the police power doctrine is essential to an understanding of the balancing approach that the Court uses in contract clause cases. The police power doctrine, which provides that contract rights are held subject to a legitimate exercise of the police power,[257] is a direct descendant of the Marshallian approach to the clause.[258] Chief Justice Marshall based his holding that the clause was an absolute barrier to any modification of a contract upon his belief that the protection of property interests was a fundamental obligation of the Court.[259] Thus, under the Marshall Court, contract clause decisions were often based upon "natural" distinctions, such as whether the statute affected the obligation of the contract or merely the remedy awarded for breach.[260]

The growing complexity of American society was creating new tensions between the reliance interests of contractors and the free-

256. *See supra* notes 42-47 and accompanying text.

257. *See supra* note 44.

258. *See supra* notes 19-69 and accompanying text.

259. WRIGHT, *supra* note 5, at 26-29; *cf.* SCHWARTZ, *supra* note 5, at 271 (The Framers intended to establish a principle that contracts must not be interfered with by legislative activity, i.e., contracts should be inviolable.).

260. *See* Hale, *supra* note 5, at 526-27; *cf.* Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 200 (1819) ("The distinction between the obligation . . . and the remedy . . . exists in the nature of things.").

dom of the government to protect the public interest in light of changing circumstances. As these tensions grew too great for the Court to ignore, it resorted to the fiction of implying conditions in contracts to give effect to the public interest. For example, once the Court had determined that corporate charters were contracts that the Constitution protected,[261] it had to find a way to curb the growing power of corporations. The Court therefore developed the doctrine that the power of the state to amend or repeal the charter was an implied condition of its granting.[262] In the same vein, the police power doctrine was originally interpreted as an implied condition in a public contract making the state's contractual obligation subject to the proper exercise of its police power.[263] Doctrinally, it would have been simpler and more direct to resolve these issues by holding that public contracts were not intended to be within the constitutional prohibition.[264]

Professor Powe[265] has recently traced the development of the police power doctrine from the dicta in *Boyd v. Alabama*[266] to the Court's holding three years later in *Stone v. Mississippi*.[267] Powe cited four cases, in which three Justices offered four different theoretical bases for the doctrine. This judicial reaction was undoubtedly a response to the rejection of the doctrine that states reserved the power to amend corporate charters. Corporations made various creative arguments as to why their charters were not subject to the doctrine. The police power concept seemed to offer a way to avoid the factual arguments inherent in the reserved power to amend the doctrine. *Boyd*, which involved the repeal of a statute authorizing lotteries, denied the "competence" of one legislature to bind later legislatures.[268] *Beer Co. v. Massachusetts*,[269] which involved a state prohibition law affecting a corporation chartered to manufacture and sell liquor, recognized the ability of the legislature to affect

261. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

262. *Id.* at 675 (Story, J., concurring); Miller v. New York, 82 U.S. (15 Wall.) 478 (1872); *see also* WRIGHT, *supra* note 5, at 167-68 (citing Chicago Life Ins. Co. v. Needles, 113 U.S. 574 (1885), as the source of this rule).

263. Justice Blackmun, at times in *United States Trust*, seems to have this conception of the doctrine when he refers to the "reserved power" of the state. United States Trust Co. v. New Jersey, 431 U.S. 1, 21 (1977).

264. Schwartz, *supra* note 2, at 99.

265. *See supra* note 10.

266. 94 U.S. 645, 650 (1876).

267. 101 U.S. 814 (1879). The intermediate cases were Beer Co. v. Massachusetts, 97 U.S. 25, 33 (1877), and Fertilizing Co. v. Hyde Park, 97 U.S. 659, 669 (1878).

268. *Boyd*, 94 U.S. at 650.

269. 97 U.S. 25, 32 (1878).

rights that had not yet vested. *Fertilizer Co. v. Hyde Park*,[270] which involved an ordinance barring fertilizer manufacturing, relied on the fact that the state's police power predated the federal constitution and that all property is held on the condition that it will not harm others. In *Stone*, another lottery case, the Court finally settled on the theory that even the people cannot bargain away the police power and that every public contract is therefore made on the implicit understanding that the government can take the right away at any time.[271]

Stone established the doctrine and provided authority for states to override both their own contracts and those between private parties.[272] Unfortunately, during the ninety-seven year interval between *Stone* and *United States Trust*, the Court was either unwilling or unable to clarify the theoretical basis for the doctrine or determine precisely when it applies.

The primary problem with the police power doctrine as the Court has promulgated it in *Stone*, is that it starts from an incorrect premise. Whether the contract clause protects a given contractual obligation is clearly a question of federal law.[273] Whether a contract is binding in the first instance upon the state that made it, however, is not and should not be a question of federal law unless the state is attempting to evade the federal constitution. The Constitution does not dictate to a state how the powers of government are to be divided between its legislature and the people. The extent to which a state can bargain away its sovereignty would appear to be a matter of state constitutional law.[274] Contract clause cases, however, have not considered state law in determining whether contracting parties can bargain away a given power. Rather, the decisions have been based upon the Justices' views regarding natural law and the theory of government. For example, in *Stone*, Chief Justice Waite contended that parties could bargain away at least part of the taxing power because the government was

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270. 97 U.S. 659, 667 (1878).

271. *Stone*, 101 U.S. at 819-20.

272. As *Blaisdell* demonstrates, the use of the police power doctrine has not been limited to public contracts.

273. *See supra* text accompanying note 229.

274. Under article 4 of the United States Constitution, the United States guarantees to each state a republican form of government. Whether a state has a republican form of government is a political question not justiciable in federal courts. Luther v. Borden, 48 U.S. (7 How.) 1 (1849). Apparently, however, Congress can enforce the guarantee. *See* Baker v. Carr, 369 U.S. 186, 218-32 (1962). But *Baker* lends support to the view that the degree of "sovereignty" that a government retains is not at issue in article 4.

not organized for taxation, even though taxation admittedly was necessary.[275] On the other hand, neither the legislature nor the people themselves could bargain away the police power because government was organized to exercise that power.[276]

It is difficult to see why the states should have less freedom to contract than individual citizens. As Professor Hale has cogently argued, a state, like a private individual, should be able to contract away some of its freedom without necessarily being permitted to contract away all of its freedom.[277] Just as our society will not permit an individual to contract himself into slavery, society need not permit a state to bargain away an unnecessarily large part of its sovereignty. Admittedly, the police power doctrine serves the useful purpose of insuring that corrupt transactions that preceding legislatures made do not burden a state; however, it is not necessary to cloud all transactions to protect the state against those few. Because the claimant must first demonstrate that its contract is valid and enforceable under state law, concepts such as fraud and unconscionability provide a remedy in the few cases of corrupt or improvident dealing. Justice Blackmun appeared to be searching for such criteria when he adopted the "reasonable and necessary" test in *United States Trust*. That test, however, comes into play only if a court determines that the original contract was valid when the parties adopted it—when the subject of the contract was an aspect of sovereignty that the state could bargain away.[278]

Even if the rationale of the doctrine is accepted at face value, characterizing the binding effect of a contract according to the government power involved is an extremely inefficient way to protect the public interest. It seems settled that the state can bargain away the taxing and spending powers because they are nonessential but that the eminent domain and police powers are inalienable.[279] The issue is simply a matter of classification. For example, Justice Blackmun in *United States Trust* recognized that "the Contract Clause does not require a State to adhere to a contract

275. Stone v. Mississippi, 101 U.S. 814, 820 (1879).

276. *Id.*

277. Hale, *supra* note 5, at 653-54.

278. *United States Trust*, 431 U.S. at 25-26.

279. *Compare* Stone v. Mississippi, 101 U.S. 814, 818 (1879) (police power is inalienable) *with* West River Bridge Co. v. Dix, 47 U.S. (6 How.) 507 (1848) (eminent domain powers are "nonalienable") *and* New Jersey v. Wilson, 11 U.S. (7 Cranch) 164 (1812) (taxation power is "alienable"). *See generally* Hale, *supra* note 5, at 638-63 (examining the implications of contracting away the power of eminent domain, the power to tax, and the police power).

that surrenders an essential attribute of its sovereignty."[280] He found, however, that the New Jersey statute was not a police power measure even though it was intended to permit the Authority to take steps to reduce pollution and urban congestion. Rejecting the use of "formalistic distinctions" regarding those powers that a state may bargain away as dispositive of the contract clause issue, he determined that the contract was binding on New Jersey because it involved a "financial obligation" of the state.[281] He recognized that there is no clear dividing line between financial and nonfinancial obligations and attempted to clarify the concept by distinguishing the 1962 covenant from a covenant that would require the state to continue to operate a facility for the term of the bonds even if a health hazard were involved.[282] This distinction, however, is not helpful. Any party can complete most contractual undertakings that become problematic provided he is willing and able to make further expenditures. For example, if a state-operated facility produced a health hazard due to pollution, the state might be able to continue to operate the facility by expending additional amounts on pollution control. It seems clear that Justice Blackmun does not intend to imply that the government is relieved from all obligations to comply with its undertakings simply because a health hazard is involved. Indeed, Justice Brennan's dissent forcefully argued that health was exactly what was involved in the case.[283]

Essentially the Court has converted every contract related to the police power into a contract revocable or impairable at will, thereby inflating the risk component of the contract price. The undesirable result from an increase in the risk that a state may unilaterally revoke a contract, which a contracting party views as an increase in the risk that the state will breach, is that states must now pay higher costs for public contracts. This proposition assumes that when a party enters into a contract with the government he knows that the state in the exercise of its police power may unilaterally impair his rights and increase his obligation. Thus, the risk the contractor takes that a state will not perform in accord with the terms expressed in the agreement is increased, and the rational contractor will increase his projected profit margin to absorb the increased risk. In a perfect world, the risk premium

280. *United States Trust*, 431 U.S. at 23.
281. *Id.* at 24-26; *see supra* text accompanying notes 80-87.
282. *Id.* at 25.
283. *Id.* at 34-41 (Brennan, J., dissenting).

that a contractor would charge would be spread among all contracts in an amount equal to the risk actually involved; but in a time of spiraling government regulation on matters of health, safety, and consumerism, it is likely that the risk premium is overestimated. Even if the risk premium were efficiently allocated among various types of contracts, the revocable nature of public contracts is inequitable because it results in windfalls or losses to the contractors involved depending upon whether a police power or taxing measure impairs a particular contract. In short, the formalistic distinction between the police power and other government powers has no sound basis in contract clause doctrine or in reason and should be discarded.

Stone v. Mississippi[284] and cases like *Atlantic Coast Line Railroad v. Goldsboro*[285] appear to give unlimited authority to legislatures to renege on earlier contracts. The Court, however, has also recognized that there are limits to the police power doctrine as it applies to public contracts. In *Illinois Central Railroad v. Illinois*,[286] the Illinois Legislature had granted to a railroad not only the entire Chicago harbor but all adjoining lands that could probably later be added to the harbor. The Court held that a revocation of the grant was constitutional because the grant was a perversion of the public trust and an abdication of governmental power. Justice Field recognized, however, that small grants of public property to improve commerce and navigation are valid if they do not substantially impair the public interest.[287] In *Appleby v. New York*,[288] the Court refused to permit New York to revoke a grant of waterfront property on Manhattan Island. The grant was within the class that Justice Field described in *Illinois Central* as binding upon the state, and the Court hinted that a desire to use the property for New York's own profit rather than a need to regulate the land for the public interest motivated New York to revoke the grant.[289] Implicit in *Appleby* is the recognition that a state could assert the police power theory to support the attempted regulation of contractual interests merely to further the economic interest of the state.

This point is made even more strikingly in *Missouri, Kansas*

284. 101 U.S. 814 (1879); *see supra* text accompanying notes 54-60.
285. 232 U.S. 548 (1914); *see supra* text accompanying notes 61-63.
286. 146 U.S. 387, 453 (1892).
287. *Id.* at 452.
288. 271 U.S. 364 (1926).
289. *Id.* at 393-95, 397-98.

& Texas Railway Co. v. Oklahoma.[290] In that case, the railway and the city had made an agreement concerning the construction of various crossings across the railway's right of way. The city was to pay for some costs and both parties were to cover the remaining expenses. A state commission had adopted an ordinance requiring the railway to pay for construction of a crossing that the city had agreed to pay for by itself. The city claimed that the original ordinance had surrendered the city's police power, and therefore, the contract with the railway was not valid. Justice Butler for the Court agreed that the contract was void if enforcement of the ordinance hampered the state's power to reasonably regulate the construction and use of railroad crossings.[291] However, he viewed the precise question involved as "whether the agreement of the city to bear the cost of construction is inconsistent with the proper exertion of the police power."[292] The Court held that the ordinance that abrogated the original agreement was void under the contract clause.[293]

The approaches of these cases indicate that the *United States Trust* "exception" to the police power doctrine should not be limited simply to disputes involving municipal bonds or other "financial obligations" of states but to all government contracts where the dispute essentially involves the allocation of the cost of enforcing the police power. Although Justice Marshall in *Exxon* may have resurrected the doctrine as it applies to private contracts, his reliance on the police power opinions that Justices Van Devanter and Butler[294] wrote, strongly indicates that the old law is still good law. There should be no question whether a state or local government may bargain away its right to impose economic burdens on others whenever the government acts as an enterprise rather than as a "mediator."[295] In the typical project agreement dispute, the question should not be whether the state can require the contractor to undertake a new statutory obligation that was not within the contemplation of the parties at the time they made the contract, but rather who is to pay for its undertaking. A court should construe the contract clause as saying to the state that it can require

290. 271 U.S. 303 (1926).

291. *Id.* at 309-10.

292. *Id.* at 307.

293. *Id.* at 310.

294. *See supra* note 152.

295. The Court has adopted this approach in commerce clause cases where the state acts as "market participant" versus "market maker." *See, e.g.*, Reeves, Inc. v. Stake, 447 U.S. 429 (1980) (citing Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976)).

different or additional equipment to be installed, in at least some circumstances, only if it is willing to bear the cost.

Similarly, the police power doctrine should be limited in its application to those regulations that impair private contracts. The contract clause does not prohibit a state from exercising its police power to protect special interests or from equalizing bargaining power unless the regulation affects reliance interests. But when legislation is retroactive in that sense, the state should not be able to override protected interests simply to shift cost from one group to another. In the private contract arena, the police power doctrine, at worst, writes the contract clause out of the Constitution and, at best, serves only to confuse analysis. Of course, a limitation of the scope of the clause to reliance interests, as suggested earlier, would drastically reduce the need for the broad police power doctrine.

In summary, the Court should have seized the opportunity in *United States Trust* to reject a broad reading of the police power doctrine as the doctrinal basis for giving effect to the public interest in an impairment situation. Instead, by focusing on "financial obligations" as a species of binding public contract,[296] the Court made it more difficult to make the contract clause doctrine consistent either with the nature of modern public contracts or with the application of the clause to private contracts. The doctrine is most pernicious when courts arbitrarily apply it to public contracts. The police power doctrine was developed when the primary forms of public contracts were the granting of corporate charters and land grants to utilities and railroads. Public contracts today are incomparably complex, and the development of the doctrines of unconscionability and fraud has reduced the dangers of collusion and corruption. Only if the state is free to enter into reasonable contracts, regardless of the subject matter, will the public interest be achieved at the lowest cost.

C. *Balancing the Police Power Interest*

The significance of *Blaisdell* was that it applied the police power doctrine in a hard-core contract clause case by holding that the mortgagee's reliance interest under a private contract was subordinated to the police power.[297] Chief Justice Hughes could have relied solely on the distinction between right and remedy, but in a

296. *See supra* text accompanying notes 78-87.

297. *See supra* text accompanying 52-58.

carefully worded opinion, he went further and relied on the police power.[298] Although not explicitly describing his approach as a balancing approach, he in effect balanced the marginal harm to the mortgagee (essentially a postponement of collection of principal) against the state's interest in maintaining a viable family farm system and preventing a collapse of the land-based economy that mass foreclosures could cause.[299] When *El Paso* adopted the same approach to less compelling facts, it seemed clear that the application of the contract clause turned less on balancing than on labeling.

The Burger Court has taken an inconsistent approach to balancing.[300] Under *United States Trust*, impairment of a contract binding on the state is not permitted simply because the benefits to the public are greater than the costs to the private contractor. This approach puts the state in a worse position than it would have been in under *Blaisdell* if the contract affected simply another private party. But Justice Blackmun rejected the idea that balancing was appropriate.[301] Rather, Blackmun's view was that the state could impair a valid contract if the impairment was "reasonable and necessary to serve an important public interest."[302]

In *Spannaus*, *Energy Reserves*, and *Exxon*, the Court superficially adopted the "reasonable and necessary" test but applied it in strange and varied ways. Under *United States Trust*, the test is to be applied to both public and private contracts once an impairment is found, but a court cannot completely defer to a state's assessment of what is a reasonable and necessary impairment of a public contract.[303] In *Spannaus*, however, the Court showed little deference even though it purported merely to apply the principles of *United States Trust* and *Blaisdell*.[304] The *Energy Reserves* court used the *United States Trust* terminology, but it in essence applied a rational basis test.[305] Justice Blackmun turned his own *United States Trust* test on its head in *Exxon* by balancing the state's interest against the absolute language of the contract clause.[306] Blackmun did not give any consideration to ERG's inter-

298. *Blaisdell*, 290 U.S. at 434.
299. *Id.* at 439-40; *see id.* at 421-23 nn.3 & 4 (the importance of Minnesota's interests).
300. *See supra* notes 83-86 and accompanying text.
301. *United States Trust*, 431 U.S. at 29.
302. *Id.* at 25, 29.
303. *Id.* at 25-26.
304. *Blaisdell*, 438 U.S. at 243-44.
305. *Energy Reserves*, 103 S. Ct. at 705.
306. *Exxon*, 103 S. Ct. at 2307.

ests, probably because he had already established that the legislation had not impaired ERG's interest and was merely trying to extricate the Court from the implications of *United States Trust* and *Spannaus*. Finally, the *Exxon* Court, after citing the *United States Trust* test, simply applied the pre-*Blaisdell* "reserved" police power test.[307] No balancing was involved because Exxon's rights had always been subject to the exercise of the police power.

It is not clear why the Court abandoned the "reasonable and necessary" test so quickly. Justice Brennan's dissent in *United States Trust* properly criticized this choice of terminology,[308] but these concepts certainly permit more consistent analysis than the Court's previous and subsequent approaches. The primary inadequacy of the police power doctrine is that it neither distinguishes between reliance interests and other contract rights nor distinguishes cases where the primary effect of the legislation is to impose on a contracting party costs unrelated to the contract or costs that society in general should bear. Recognition of reliance interests invites a balancing that traditional pre-*Blaisdell* doctrine does not permit. The allocation problem requires consideration of fairness (or "reasonableness," in *United States Trust* terms) to determine if the legislature is taking advantage of either its legislative power to obtain benefits in public contracts or of the lack of political power of the adversely affected parties to impose societal costs on private contracts. Although *United States Trust* did not satisfactorily resolve these issues, its effort is more praiseworthy than the haphazard efforts of the later cases.

If the analysis proposed in this Article were adopted, courts would seldom reach the balancing issue. The clause would protect only reliance interests. The claimant could not seek relief under the clause unless an inverse condemnation remedy was not available, and no impairment would be found unless both the promissory rights and remedial rights were affected. Because these proposals would narrow the scope of the clause and eliminate many of the issues that led to the development of the police power doctrine, there is no need for such a draconian approach at this stage. The purpose of the proposed analysis is to bring only potential "core" cases within the scope of the clause in the first place. Such an analysis would moderate the absolute nature of the clause and drastically reduce its potential interference with the exercise of the po-

307. *Id.*
308. *United States Trust*, 431 U.S. at 54 n.17.

lice power. The only cases left open would be those in which the state claims that the purpose of the statute is so important that universal application cannot be postponed just to satisfy the reliance interest of the claimant. Incorporating the traditional police power doctrine at this stage of the analysis would virtually write the clause out of the Constitution.

The proposed analysis does not mean, however, that the clause requires absolute protection even for this narrow class of interests. There may be cases where the state's interest is so compelling that even core interests must give way. The *United States Trust* approach provides a useful starting point in the search for a solution to this problem.

An evaluation of the *United States Trust* test should begin with a consideration of the relative protection to be afforded property rights as opposed to personal rights and of the discretion to be afforded the judiciary in evaluating the legislature's views as to the public interest. The scope of judicial review given to state legislation reflects both factors, but they are not identical. The test that a court adopts should impose a more difficult hurdle for state legislation than does the police power doctrine while permitting relatively little scope for judicial activism or, perhaps put more accurately, judicial conservatism.

The reasonableness requirement of the *United States Trust* test focuses on the legitimate expectations of the parties when they made the contract. As Chief Justice Burger stated in his concurring opinion in *United States Trust*, the reasonableness test is satisfied for a public contract if the state shows that when the contract was made, it did not and could not know of the impact of the contract on the state interest underlying the challenged statute.[309] The New Jersey statute in *United States Trust* did not pass this test.[310] This reasonableness test dramatically differs from the *Blaisdell/El Paso* approach in that it does not involve a balancing of the merits of the goals of the legislation against the damage to

309. Admittedly, as Justice Brennan argues, the term "reasonable" is confusing because it is also used in describing the minimal scope of judicial review applied to economic regulatory statutes. *See supra* text accompanying note 92. It is the traditional test, however, that is misnamed. The test is one of possible rationality: There is or should be a distinction between a statute with merely a conceivable basis and a statute that rationally furthers an articulated governmental objective. *See* United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166, 184, 188 (1980) (Brennan, J., dissenting). Moreover, the test is similar to the traditional test because the judge is not permitted to second guess the legislature's determination of the need for the statute. The test is one of foreseeability.

310. *See supra* text accompanying notes 88-89.

the private interest.

The reasonableness test is closely related to the reliance concept used in determining whether an "obligation" exists. If a party had no reasonable expectation that he would receive a benefit from the promise of the other party, no reasonable reliance or "obligation" may arise. But that does not mean that the reasonableness test is redundant.[311] Experience has shown that beneficiaries of legislation will argue changed circumstances as a justification for impairment even when a reliance interest is clearly present.[312] The reasonableness test insures that such an argument is rejected in appropriate cases. For example, when parties enter into a private contract, the reasonable foreseeability of regulation might prevent a party from relying on a contract right. When the impact of the contract on the beneficiary has changed in an unforeseeable manner since contracting, however, the statute still may be enforceable. This may be the case even if a reliance interest arose because the development was *not* foreseeable.[313]

The effect of the reasonableness test is therefore limited in private contract cases. It is unlikely that a claimant will be able to meet its burden of demonstrating that the legislature was unreasonable in concluding that the beneficiaries of a statute on the average should not have anticipated the problem that the statute seeks to remedy. For example, even if Allied had demonstrated a reliance interest in *Spannaus*, a court could properly hold that the Minnesota Legislature acted "reasonably" in determining that employees could not appreciate the effect of a plant foreclosure on their pension rights because of their lack of sophistication. In short, a state legislature still has substantial power and authority

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311. The tort of negligence provides an analogy. Even though foreseeability is the primary determinant of both duty and proximate cause, analyzing the concepts separately aids understanding and precision.

312. *United States Trust* and Continental Ill. Nat'l Bank v. Washington, 696 F.2d 692 (9th Cir. 1983), are just two recent examples. An egregious example is Fertilizing Co. v. Hyde Park, 97 U.S. 659, 669 (1878), where the Illinois Legislature granted a charter to a rendering plant to operate outside the city limits and later forced it to move when the city that subsequently developed around it passed an ordinance that effectively made the plant a nuisance.

313. Examples of "reasonable" statutes that could impair reliance interests other than a true windfall profit limitation are difficult to imagine. *See supra* text accompanying notes 125-26. Justice Blackmun provided another example in *United States Trust*. In his hypothetical, a state gives a promise to continue operating a facility to secure a revenue bond. A court could never construe such a promise to be binding on the state where legislation promulgated to protect health and safety requires that state authorities close the facility. *See* United States Trust Co. v. New Jersey, 431 U.S. 1, 25 (1976).

under the contract clause to adopt paternal legislation.

The reasonableness test will be of primary importance in public contract cases. There is a strong intuitive appeal to the concept that the government should not get two bites at the contract apple just because it is the government. If the people collectively make a bad deal they should be stuck with it just as they would be if they had acted as individuals.[314] This argument is the inverse of the notion that the legislature has no more power than the people. Notions of efficiency and equity support this argument because it forces the government to devote close attention to its fiscal affairs when contracting in an effort to avoid wasting resources inherent in promulgating legislation at a later time to avoid a contractual obligation or deprive the other contracting party of a contractual right.

Judges can, of course, manipulate the reasonableness test to invalidate legislation with which they do not agree, but the test does not require a judge to impose his own value judgments in determining whether a state has violated the contract clause. In contrast, the potential for judicial overreaching is also a major problem with the "necessary" part of the *United States Trust* test.[315] The reasonableness test focuses on forseeability, a concept that should be familiar to every judge. There is little reason to believe that the difficulty of proving foreseeability will be any different here than in other areas of the law. The necessary test, on the other hand, requires a judge to reassess the legislature's decision on factual matters even if the court does not have the necessary expertise to do so. Moreover, whether total repudiation of a contractual agreement is essential, or whether a legislature has means other than promulgating a statute to achieve a legislative objective, is irrelevant to a judicial determination that a statute violates the contract clause. The purpose of the contract clause should be to protect the legitimate reliance interest of the contractor. That contractual interest is not entitled to any more protection than any other property interest against unwise or unnecessary legislative action. Although the contract clause may give contract interests more protection than that which other property rights receive under the Constitution, this extra protection should only be available when a law arbitrarily or discriminatorily affects contract rights

314. El Paso v. Simmons, 379 U.S. 497, 529-32, *reh'g denied*, 380 U.S. 926 (1965) (Black, J., dissenting) (party that contracted with Texas constitutionally and equitably entitled to its rights under the agreement).

315. *See supra* text accompanying notes 84-87.

on which a party to a contract has relied.

The reasonableness test appears to be consistent with the goals of the contract clause, but the necessary test is unappealing because it lends itself to a substitution of judicial judgment for legislative judgment. It does not follow, however, that the concept of reasonableness should be the sole test to determine whether an impairment is in fact unconstitutional. Indeed, one can envision common contractual situations in which an alleged impairment would satisfy the reasonableness test and yet still entail an arbitrary element of government action. For example, assume the state has sold to a corporation a right-of-way over public lands to build and operate a petroleum pipeline. The right-of-way contract includes standards to protect against environmental damage that leaks may cause in the line. If it later unexpectedly develops that the material used to wrap the pipeline to protect against leaks is an attractive, yet deadly foodstuff for wildlife, a court could justifiably conclude that legislation that requires the company to remove or cover the wrapping is "reasonable." Legislation, however, that requires the corporation to raise the pipeline an additional six feet above the ground is arbitrary if a less drastic, but equally effective measure, such as using different wrapping, is readily available.

This is the type of issue that the necessary test resolves. The Court's *United States Trust* test incorporates the necessary test but goes one step further because it also requires that *the court* determine whether the legislation was essential to the achievement of a legislative purpose.[316] A better solution would be to adopt the "studied indifference" approach of *W.B. Worthen Co. v. Kavanaugh*.[317] Under this test, the contract clause at a minimum prohibits the state from adopting as a policy the destruction or nonen-

316. *See supra* text accompanying notes 84-87.

317. 295 U.S. 56 (1935). *Kavanaugh* involved an Arkansas statute that modified the foreclosure provisions relating to the security for district improvement bonds issued three years before the Arkansas legislature passed the amending statute. Justice Cardozo, in reversing the decision of the Supreme Court of Arkansas upholding the statute, found that the statute did not provide the same protections to the mortgagees as the Minnesota statute did in *Blaisdell*. He wrote: "With studied indifference to the interests of the mortgagee or to his appropriate protection" the framers of the statute "have taken from the mortgage the quality of an acceptable investment for a rational investor." *Id.* at 60. Justice Cardozo prefaced this statement with the caution that he was stating the "outermost limits" of the police power and that the bounds could be even narrower. *Id.* The effect of the Arkansas statute was to extend the interval between default by a landowner on assessments and foreclosures from approximately sixty-five days to over two and one-half years. *Id.* at 61. In addition, the extension of a redemption period left the trustee for the bonds without a remedy for six and one-half years. *Id.*

forcement of contracts.[318] "Studied indifference" is no less vague than "necessary," but it is intended to require the same type of legislative attention to the interest of affected parties as that displayed in *Bliasdell*.[319] As long as the beneficiary can demonstrate that the legislature has made an effort to recognize the reliance interests of contractors, the legislature's decision cannot be attacked as arbitrary.[320]

The "studied indifference" test, which requires less judicial interference with legislative activities than the *United States Trust* approach, deserves a more thorough trial than it has received.[321] As Justice Black argued in *El Paso*, the test is not a guaranty against arbitrary government action.[322] The primary weakness of the *El Paso* decision, however, is not the fact that the legislature was able to meet the studied indifference test by demonstrating that it had tried less drastic measures to remedy the problem. Rather, it was, as Black recognized, that the Court made an unfounded assertion regarding the "legitimate expectations" of the parties at the time they contracted.[323]

The studied indifference test would prevent legislatures from adopting purely political solutions to many economic problems without permitting the judiciary to select among arguably reasonable alternatives available to the legislature. The classic debtor-relief measure may no longer be a real danger, but its spirit lurks in the form of statutes like the pass-through prohibition in *Exxon*[324] and the repeal in *United States Trust*;[325] it may even be present in *Energy Reserves*. The contract clause at a minimum means that the state cannot solve even serious economic problems by selecting parties with reliance interests to bear the full burden. To use a

318. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 439 (1934).

319. *Id.*

320. *Cf.* Note, *supra* note 252, at 1638 n.75 (judicial deference to legislature rests on the assumption that a functionally proper political process makes policy determinations and factual judgments).

321. Justice Brennan believes that *Kavanaugh* is the "prime exposition of the modern view" of the role of the contract clause, *United States Trust*, 431 U.S. at 55-56 (Brennan, J., dissenting), and that Justice Cardozo's test provides an adequate safeguard against arbitrary government action. *Id.* at 56-57. Interestingly, however, the *Kavanaugh* court distinguished *Blaisdell* based on the *Blaisdell* facts of limited interference with the mortgagee's rights and reliance on court involvement in protecting the mortgagee. Cardozo stated that W.B. Worthen Co. v. Thomas, 292 U.S. 426 (1934), governed *Kavanaugh*. *Kavanaugh*, 295 U.S. at 63. *Kavanaugh* then is not necessarily more protective of the police power than *Blaisdell*.

322. *El Paso*, 379 U.S. at 528-33.

323. *Id.* at 529-30.

324. *Exxon*, 103 S. Ct. at 2299-300.

325. *United States Trust*, 431 U.S. at 9-14.

fertile metaphor, the legislature cannot napalm contract rights when pruning shears will do the job, nor can it trample even the weeds of reliance interests just because it is easier to clear the way for economic justice by doing so. That does not mean that the legislature cannot ultimately trample the weeds but only that it must first decide whether it can achieve its goal in less drastic (for the weeds) fashion. Thus, the Court may have rightfully decided *Energy Reserves* and *Exxon*,[326] but the Court should have required the proponent of the legislation to demonstrate a need for the interference.[327]

VIII. CONCLUSION

The Supreme Court's decisions in *United States Trust* and *Spannaus* created more issues than they resolved, and it appears that *Energy Reserves* and *Exxon* will have the same effect. Substantial gaps and ambiguities continue to plague the contract clause doctrine. This Article suggests a remedy designed to reduce contract disputes involving constitutional questions to a minimum by limiting the scope of the contract clause to cases in which legislation would have a severe retroactive effect on reliance interests. In a sense, this approach accepts the validity of Justice Holmes's aphorism that parties may not prevent legislation from affecting their property by making a contract about it,[328] and adds to it the concept that a state cannot obtain unbargained-for benefits, for itself or for a favored class, simply by passing pertinent legislation.

Courts should reject the notion that a party entering into a contract assumes the risk that any exercise of police power can arbitrarily affect his contractual duties and rights because that idea leads to hidden costs to the public and inequitable results among contracting parties. The legislature and administrative agencies should be free to determine what is in the best interest of the people at any given time by entering into binding contracts. The courts should permit interference with contract rights only when

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326. *Energy Reserves*, 459 U.S. 400 (1983); *Exxon*, 103 S. Ct. at 2296.

327. This does not necessarily mean that a court must limit its consideration of legislative purposes to those stated in the statute. *But cf.* Zobel v. Williams, 457 U.S. 55 (1982) (no rational basis upon which legislation in question could be imposed to further a legitimate state purpose); Schweiker v. Wilson, 450 U.S. 221, 244 (1981) (Powell, J., dissenting) (defining the rational basis test).

328. "One whose rights, such as they are, are subject to state restrictions, cannot remove them from the power of the state by making a contract about them." Hudson Water Co. v. McCarter, 209 U.S. 349, 357 (1908).

(a) there is no reliance interest, (b) a contract or inverse condemnation remedy is available, (c) enforcement of the contract against the public would be unconscionable, *or* (d)(1) the contract has unforeseen effects that adversely affect the public interest and (2) the legislation demonstrates a due regard for the protection of reliance interests. Conversely, a statute should be unconstitutional under the contract clause only when it (a) prevents or restricts enforcement of a reliance interest, (b) cannot be compensated under contract law or the taking clause, and (c)(1) has unforeseeable adverse impacts or (2) reflects abdication by the legislature of its responsibility to show due regard for such interests. Courts should also reject the idea that the public should not bear the risk of a bad bargain that the government made. State and local governments should have the same capacity to enter into binding contracts as individuals. The general public should share losses on public contracts rather than the contractor who has more accurately evaluated the risks involved.

The application of this approach leads to the conclusion that the Court wrongly decided *United States Trust*.[329] The Court should have limited the bondholders to an action for inverse condemnation unless it was found that valuation of the 1962 covenant was too speculative. If inverse condemnation was not available, the Court should have held the repeal of the covenant to violate the contract clause, because it failed both the reasonable and the studied indifference tests. The statute failed to satisfy the studied indifference test because no effort was made to provide substitute protection to the bondholders. To argue that other covenants adequately protected the bondholders at the time of repeal is to ignore the vagaries of the financial world and the generally recognized need for both a belt and suspenders to protect against contingencies. State and local governments should not have the right to simply change their minds regarding the wisdom and value of their contracts. Parties contracting with the government should be protected from the government's greed or whimsy.

The Supreme Court wrongly decided *Spannaus*[330] because the statute did not affect a reliance interest of the employer's or, if it did, the statute dealt with contingencies that the employees arguably did not appreciate when the contract was made and resolved the issue with due concern for employers' interests. The Court cor-

329. *See supra* text accompanying notes 70-92.

330. *See supra* text accompanying notes 93-104.

rectly decided *Energy Reserves*[331] because ERG appeared not to have any right under state law that had been affected. Even if it had a right, it could have protected itself by using a *force majeure* provision. Whatever rights ERG had were therefore not reliance interests that the contract clause protected. The Court also rightly decided *Exxon*[332] because no reliance interest was apparent. From a doctrinal point of view, however, the Court wrongly decided both *Energy Reserves* and *Exxon* because both opinions relapsed into an uncritical use of the Holmes aphorism[333] and failed to adequately explain apparent shifts in doctrine.

331. *See supra* text accompanying notes 110-23.
332. *See supra* text accompanying notes 136-52.
333. *See supra* note 328 and accompanying text.