# THE ROLE OF THE CONTRACT CLAUSE IN MUNICIPALITIES' RELATIONS WITH CREDITORS

When a state legislature goes to the aid of a financially troubled city, it must consider whether its rescue attempts will be thwarted by the contract clause of the Constitution.[1] Once, perhaps, a strict interpretation of the contract clause forbidding "any law which releases a part of [a contractual] obligation"[2] would have forced state legislatures to stand idle while municipal creditors demanded total fulfillment of their rights and remedies against the city.[3] Now, however, the case law interpreting the contract clause suggests a number of approaches by which a state legislature may respond to creditors' demands with less than absolute compliance.[4]

In viewing a municipality's relations with its creditors, three situations in which state legislation arguably impairs contracts will be examined: (1) alteration of contractual obligations and remedies when no financial emergency exists; (2) legislative maneuvering in a financial emergency; (3) state "bankruptcy" legislation, and conservation of municipal resources in the post-bankruptcy period. Before examining what barriers the contract clause may still pose in these contexts, however, it is necessary to understand how it is that the contract clause regulates a city's relations with its creditors.

## I. APPLICABILITY OF THE CONTRACT CLAUSE

The term "contract" as used in article I, section 10 should be con-

1. "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." U.S. CONST. art. I, § 10.

2. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 197 (1819).

3. The Marshall Court expanded the contract clause in a series of cases to give it a literal application to contracts in existence at the time the state legislature seeks to alter its obligations. E. CORWIN, THE CONSTITUTION AND WHAT IT MEANS TODAY 104 (13th ed. 1973); Funston, *Requiescat in Pace: A Memorial to the Contract Clause*, 31 FED. BAR J. 350, 351-52 (1972); Hale, *The Supreme Court and the Contract Clause* (pt. 1), 57 HARV. L. REV. 512, 530-31 (1944). *See generally* B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION 27-53 (1938). The interpretation of the Marshall period was solidified and applied in defense of private property interests during the tenure of Chief Justice Taney from the mid-1830s to the mid-1860s. *Id.* at 63.

4. "Generally speaking, the protection afforded by [the contract] clause does not today go much, if at all, beyond that afforded by Section I of the Fourteenth Amendment." E. CORWIN, *supra* note 3, at 104; *see* Funston, *supra* note 3, at 359; Note, *The Continuing Vitality of the Contract Clause of the Federal Constitution*, 40 SO. CAL. L. REV. 576, 589 (1967).

sidered in its "usual or popular sense as signifying an agreement of two or more minds, upon sufficient consideration, to do or not to do certain acts."[5] The first case requiring an interpretation of the contract clause by the Supreme Court established that contracts between the state and private individuals, embodying, as they must, a promise by the legislature or by officials to whom the power to contract for the state has been delegated, are within the purview of the contract clause and may not be "impaired" by subsequent legislation.[6] It is also well established that contracts between individuals and municipal corporations receive contract clause protection.[7]

Judicial decisions have superimposed a requirement that the statutes in force at the time of the making of a contract be deemed incorporated, as though by reference, into that contract for purposes of application of the contract clause.[8] Thus, laws which affect the validity, construction, discharge or enforcement of an existing contract are all subject to circumscription by subsequent legislation modifying the obligation.[9]

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5. Crane v. Hahlo, 258 U.S. 142, 146 (1922). Impairment of non-contractual obligations is not covered by article I, section 10. *See, e.g.*, Louisiana *ex rel.* Folsom v. Mayor of New Orleans, 109 U.S. 285 (1883) (tort judgment against city for mob violence not a contractual obligation and not protected); Garrison v. City of New York, 88 U.S. (21 Wall.) 196, 203 (1875) (judgment for compensation in eminent domain proceeding not protected by contract clause). *See also* Hale, *The Supreme Court and the Contract Clause* (pt. 2), 57 HARV. L. REV. 621, 622-23 (1944).

A judgment or garnishment may be protected by the contract clause, however, if the procedure for obtaining judgment is altered, since the means of enforcement of the contract—a substantial right—may thereby be impaired. W.B. Worthen Co. v. Thomas, 292 U.S. 426, 432 (1934). See notes 8-9 *infra* and accompanying text.

> 6. Is the [contract] clause to be considered as inhibiting the state from impairing the obligation of contracts between two individuals, but as excluding from that inhibition contracts made with itself?
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> The words themselves contain no such distinction. They are general, and are applicable to contracts of every description. Fletcher v. Peck, 10 U.S. (6 Cranch) 87, 137 (1810).

One commentator, however, has expressed the opinion that "[a]s an original proposition, it seems quite arguable that the contract clause was not intended to do away with a state's power to repudiate its own promises." Merrill, *Application of the Obligation of Contract Clause to State Promises*, 80 U. PA. L. REV. 639 (1932).

7. *See, e.g.*, Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942); Wolff v. New Orleans, 103 U.S. 358 (1880); Meriwether v. Garrett, 102 U.S. 472 (1880); Mount Pleasant v. Beckwith, 100 U.S. 514 (1879).

8. "To know the obligation of a contract we look to the laws in force at its making." W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 60 (1935); *accord*, Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 429-30 (1934); Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 550 (1866). *See also* Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819). *But cf.* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 343 (1827) (Marshall, C. J., dissenting): "We have, then, no hesitation in saying that, however law may act upon contracts, it does not enter into them, and become a part of the agreement."

9. Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 550 (1866); *see*

The standards for evaluating state alteration of municipalities' contracts with creditors are necessarily influenced by the stringency of the judicial review of such legislative action. The general view is that when a state, or a city acting as a representative of the state, becomes a party to a contract "the same rules of law are applied to her as to private persons under like circumstances."[10] At one point in the history of the contract clause the Supreme Court seemed to distinguish between situations in which municipal corporations were performing inherently governmental functions (*i.e.*, actions traditionally associated with sovereignty) and those in which they were acting in a proprietary capacity. Under this view, contracts involving proprietary acts would be enforced as though they were between private individuals,[11] while contracts related to government administration would receive less protection from state alteration. Subsequently, however, the Court recognized that the constitutional proscription against impairment of contracts should not affect a state's legitimate exercise of its police power,[12] and the governmental function/proprietary activity distinction lost its importance. The Court began to categorize all contracts which were created for public purposes and which related to subjects affecting public safety and welfare as contracts "within the supervising power and control of the legislature," so that when such contracts were statutorily altered the contract clause "[could not] in every case be successfully

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Edwards v. Kearzey, 96 U.S. 595, 600 (1878).

10. Davis v. Gray, 83 U.S. (16 Wall.) 203, 232 (1873); *see* Wood v. Lovett, 313 U.S. 362, 369 (1941) (obligation of state arising out of its deed of grant is as much protected by the contract clause as an agreement of an individual); *cf.* Treigle v. Acme Homestead Ass'n, 297 U.S. 189, 197 (1936) (legislature has no greater right to interfere with private contracts of quasi-public corporations than it would have to attempt a similar interference in the case of a private corporation). *But see* Comment, *The Constitutionality of the New York Municipal Wage Freeze and Debt Moratorium: Resurrection of the Contract Clause*, 125 U. PA. L. REV. 167, 187-88 (1976) (state's contracts subject to stricter review than are those of private parties). This commentator's position is supported largely by the empirical observation that "[t]he Supreme Court has often invoked the contract clause to prevent states from repudiating their financial obligations." *Id.* at 199; *see id.* at 199-210.

11. Mobile v. Watson, 116 U.S. 289, 304-05 (1886); Broughton v. Pensacola, 93 U.S. 266, 269 (1876); *see* Merrill, *supra* note 6, at 647-50. According to this distinction, when states and cities borrowed money and contracted to repay it with interest, they were to be treated as acting in a proprietary capacity so that "their contracts have the same meaning as that of similar contracts between private persons." Murray v. Charleston, 96 U.S. 432, 445 (1878).

12. See notes 99-148 *infra* and accompanying text for a discussion of standards used to determine the latitude a state has in exercising its police power in a way that alters contract rights.

invoked."[13] Thus, the legitimacy of the relationship between the state's police power and the subject matter and purpose of a contract has become determinative of the degree of state intervention which the courts will allow.[14] Insofar as the health, safety and welfare of the people are more likely to be involved in purely governmental functions than in state or municipal proprietary functions, states are likely to be allowed greater leeway in regulating contracts relating to a municipality's governmental affairs.[15]

## II. NORMAL MUNICIPAL CREDITOR RELATIONS

### A. *Nature of an Unconstitutional Impairment*

There may be any number of reasons—some, perhaps, unrelated to economic considerations—why a state decides to alter the rights or remedies of a municipal creditor. Two very recent cases illustrate the ways in which a state legislature may suddenly alter the status of a creditor who thinks that his rights are settled and enforceable.

The New York state legislature had empowered the Jones Beach State Parkway Authority to operate and collect revenues from the parkway[16] for the benefit of the Authority's bondholders. In addition, the state had expressly covenanted that it would not "limit or alter" those rights vested in the Authority.[17] Thereafter, the Authority raised the toll on one stretch of the parkway from ten to twenty-five cents.[18]

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13. Chicago B.&Q.R.R. v. Nebraska, 170 U.S. 57, 72 (1898), *quoted with approval in* Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 514-15 n.2 (1942); *cf.* Louisville & N.R.R. v. Kentucky, 161 U.S. 677, 695 (1896).

14. If contracts in furtherance of proprietary functions of a municipality affect the public health, safety and welfare, they are subject to the proper exercise of the state's police power regardless of the contract clause. *See* Chicago B.&Q.R.R. v. Nebraska, 170 U.S. 57, 72 (1898): "The presumption is that when . . . contracts are entered into it is with the knowledge that parties cannot, by making agreements on subjects involving the rights of the public, withdraw such subjects from the police power of the legislature." *See also* Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942) (composition or adjustment of claims of creditors of an insolvent municipality is within police power of state, and specific plan in question did not contravene contract clause).

Likewise, contracts between private individuals may be subject to impairment by exercise of the state's police power. *See, e.g.*, Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940) (in exercise of police power, state could restrict withdrawal rights of building and loan association certificate holders).

See notes 114-22 *infra* and accompanying text for a discussion of the relationship required between legislation which causes an "impairment" and state police power goals.

15. Similarly, a contract relating to the proprietary affairs of government is more amenable to state regulation than is a contract between private individuals.

16. N.Y. PUB. AUTH. LAW § 153-b(5) (McKinney 1962).

17. *Id.* § 158-a(1).

18. Patterson v. Carey, 52 App. Div. 2d 171, 174, 383 N.Y.S.2d 414, 416 (1976).

In response, the state legislature enacted legislation rolling back the toll to ten cents and establishing procedures which the Authority was required to follow prior to any future toll increases.[19] In *Patterson v. Carey*,[20] the Authority's bondholders challenged both the toll rollback and the newly imposed procedures as impairing their contractual obligations. The Appellate Division of the New York Supreme Court held that the new procedural requirements did not work any impairment of the bondholders' rights,[21] but the court condemned the toll rollback as an impairment which could not be justified as an exercise of state police power.[22]

In the second case, *United States Trust Co. v. New Jersey*,[23] bondholders of the Port Authority of New York and New Jersey challenged repeal of a previous legislative covenant between themselves and the states of New York and New Jersey.[24] The covenant had been part of an act which authorized the Port Authority to construct the World Trade Center and to acquire the Hudson and Manhattan Railroad[25] and which, by its terms, precluded New York, New Jersey and the Port Authority from spending the Authority's revenues and reserves for the purpose of subsidizing passenger railroads unless certain economic criteria were met.[26] A New Jersey lower court held that repeal of the covenant was a proper exercise of state police power; accordingly, any resulting impairment was not constitutionally impermissible.[27] The New Jersey Supreme Court affirmed in a per curiam opinion.[28]

In cases such as these it must first be determined whether there has been an actual impairment of the obligations of the contracts in issue, and second, if so, whether it is of a character which is constitutionally proscribed. Essential to the question of whether a law has the effect of "impairing the Obligation of Contracts" are the definitions of the terms "obligation" and "impairing." The obligations protected by the contract clause have already been outlined.[29] Not all obligations,

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19. N.Y. PUB. AUTH. LAW, § 153-c (McKinney 1962).
20. 52 App. Div. 2d 171, 383 N.Y.S.2d 414 (1976).
21. *Id.* at 178, 383 N.Y.S.2d at 419.
22. *Id.* at 177, 383 N.Y.S.2d at 418.
23. 134 N.J. Super. 124, 338 A.2d 833 (1975), *aff'd per curiam*, 69 N.J. 253, 353 A.2d 514, *prob. juris. noted*, 96 S. Ct. 3188 (1976).
24. 1974 N.J. Laws ch. 25 (repealing act).
25. N.J. STAT. ANN. § 32:1-35.50 (West 1963).
26. *Id.* § 32:1-35.55.
27. 134 N.J. Super. 124, 383 A.2d 833 (1975).
28. 69 N.J. 253, 353 A.2d 514 (1976).
29. See notes 5-9 *supra* and accompanying text. In summary, protected obligations

however, have been accorded the same degree of protection by the Supreme Court. Differing results in cases dealing with similar obligations can be explained in terms of the Court's theory of what constitutes an impairment for contract clause purposes.

At first, the Court appeared to consider *any* impairment of a contract by state legislation to be a violation of the contract clause, and to find such an impairment whenever the value of the contract was diminished.[30] Nevertheless, it was recognized that states could alter the form of the contractual remedy if "no substantial right secured by the contract [was] thereby impaired."[31] In order to determine whether a substantial right was involved, changes of remedy were subjected to the same scrutiny as alterations of rights.[32] As will be seen, these positions have been modified in subsequent cases: the right-re-

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include the rights and remedies incorporated into the terms of the contract or legislative covenant as well as the laws existing at the time the contract is made.

30. One of the tests that a contract has been impaired is, that its value has by legislation been diminished. It is not, by the Constitution, to be impaired at all. This is not a question of degree or manner or cause, but of encroaching in any respect on its obligation, dispensing with any part of its force. Planters' Bank v. Sharp, 47 U.S. (6 How.) 301, 327 (1848).

*Accord,* Green v. Biddle, 21 U.S. (8 Wheat.) 1 (1823).

31. Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 553 (1866); *see* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 430-31, 434 n.13 (1934); Bronson v. Kinzie, 42 U.S. (1 How.) 311, 316 (1843). The Court has consistently recognized that statutory changes of a remedy for enforcement of contract rights will be constitutional even if applied retroactively so long as the contract is not thereby "impaired": "Without impairing the obligation of the contract, the remedy may certainly be modified as the wisdom of the nation shall direct." Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 200 (1819). Of course, such a statement merely assumes the conclusion until a standard is developed for determining what sorts of modifications of remedies constitute impairments. This problem is discussed at notes 36-72 *infra* and accompanying text. For illustrations of statutory modifications of remedies which were upheld or assumed to be proper during the early history of the contract clause, see Penniman's Case, 103 U.S. 714 (1880) (statute abolishing imprisonment for debt upheld as applied to a debt judgment rendered before statute was passed); Bronson v. Kinzie, 42 U.S. (1 How.) 311, 315-16 (1843) (dicta assuming that retroactive application of alterations in statutes of limitations or exemption laws would not conflict with the contract clause).

32. The question of whether a legislative act which purports to alter only contractual remedies will be treated with more deference than one which touches rights is an issue which has been considered from the earliest days of contract clause construction. In Green v. Biddle, 21 U.S. (8 Wheat.) 1 (1823), the Court expressed the view that if the remedy was changed so as "materially to impair" contract rights, the result would be "as much a violation of the compact as if [the law] overturned [the obligee's] rights and interests." *Id.* at 17. But this language merely measures the extent of a change of remedy in terms of whether it impairs a right. It does not settle whether any alteration of rights could be tolerated on a theory that contractual value is not affected or on some other theory that would avoid characterizing the alteration as an impairment. *See also* Bronson v. Kinzie, 42 U.S. (1 How.) 311, 315-18 (1843).

medy distinction has been implicitly abolished,[33] the police power rationale protects some legislative impairments from constitutional sanction,[34] and, while the value of the contract is still measured in terms of its worth in dollars and cents at the time of performance, it has been held that an obligee is not entitled to obtain greater value as a result of a default than he could have obtained from the obligor's performance.[35]

For the most part, the Court has taken a practical approach to the concrete facts presented by each case in deciding whether there has been an impairment.[36] Examination of such cases yields several generalizations concerning the standards to be used in determining whether the value of an affected contract has been reduced. In *Von Hoffman v. City of Quincy*,[37] the Court reviewed a state statute which limited to fifty cents on each hundred dollars' worth of property the amount of tax which Quincy could levy to meet its debts and expenses.[38] The statute was challenged by a holder of Quincy's municipal bonds which had been issued at a time when state legislation authorized the levying of a special tax sufficient to pay the bond coupons as they came due.[39] The Court stated that if a deficiency in bond coupon payments would occur because of the taxing limitations imposed by the new law, the bondholders' contract rights would be deemed impaired; if no tax revenues would be available for coupon payments after city expenses were paid, the bond contract could be regarded as "annulled."[40] The Court went on to find that the amount which the city could collect under the new tax law, after first providing for payment of current city

33. *See* Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 550 (1866), *quoted with approval in* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 430 (1934): "[N]othing can be more material to the obligation than the means of enforcement." The Court viewed the distinction as "one rather of form than substance." *Id.* at 554.

The more recent cases have tended toward a view similar to that taken in *Von Hoffman*, refusing to base factual analyses or legal conclusions on distinctions between right and remedy: "[D]ecisions dating from *Home Bldg. & Loan Ass'n v. Blaisdell* . . . have not placed critical reliance on the distinction between obligation and remedy." City of El Paso v. Simmons, 379 U.S. 497, 506 n.9 (1965). *See, e.g.*, W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 60, 62 (1935); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 430-34 (1934). *See generally* Hale, *supra* note 3, at 533-57, especially 556-57.

34. See notes 99-148 *infra* and accompanying text.

35. See notes 67-72 *infra* and accompanying text.

36. *See, e.g.*, Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535 (1866).

37. *Id.*

38. *Id.* at 549.

39. *Id.* at 548-49.

40. "To the extent of the deficiency the obligation of the contract will be impaired, and if there be nothing applicable, it may be regarded as annulled." *Id.* at 554.

expenses, would not be sufficient to pay the bond debt.[41] On this basis, the Court nullified the law as an unconstitutional impairment and issued a writ of mandamus to compel the imposition and collection of the taxes authorized when the bonds were originally issued.[42] Thus the Court looked to the legislation's practical effect of preventing the city from fulfilling its obligation to bondholders in determining that the statute worked an impairment.

A case decided fourteen years after *Von Hoffman* illustrates even more clearly that the Court considers impairment to be a function of the practical effect of a challenged statute rather than of an abstract consideration of its provisions. In *Louisiana v. New Orleans*[43] it was held that an impairment would result if legislation tended "to postpone or retard the enforcement of the contract. . . ."[44] The Court refused to find an impairment in that case even though the challenged statute on its face seemed to do just that.[45] Although the state legislation limited the fund from which creditors of the city of New Orleans could satisfy their claims, the facts of record in the case did not show that there was not enough in the city treasury to pay the complainant's claims.[46] The Court determined on the basis of this finding that the practical effect of the legislation at the time when the creditor sought

41. *Id.*

42. *Id.* at 555. Though the Court "cannot make laws when the state refused to pass them," it can and does nullify state legislation which contravenes the contract clause and compel state officers to levy and collect taxes and to apply the proceeds as authorized under state law. Meriwether v. Garrett, 102 U.S. 472, 520-21 (1880) (Field, J., concurring). See notes 228-40 *infra* and accompanying text relating to states' powers to revoke or alter municipal charters.

43. 102 U.S. 203 (1880).

44. *Id.* at 207. The Court was explicit about the type of state legislation which would impair a contract:

> Whatever legislation lessens the efficacy of [the means provided by law by which a contract can be enforced] impairs the obligation. If it tend to postpone or retard the enforcement of the contract, the obligation of the latter is to that extent weakened. *Id.* at 206-07.

45. At issue was the validity of an act divesting state courts of authority to issue mandamus orders directing officers of the city of New Orleans to enforce city creditors' claims. The statute also included a new requirement that city creditors file and register their judgments, at which time a warrant would be issued for the amount due. Payment was to come not from a specific appropriation but rather from an amount designated in the city budget for payment of such judgments. The act further provided that when the designated fund was exhausted, the common council could appropriate payment from the amount set aside for contingent expenses; if the council did not do so, the judgment would be paid in the order of its registration from the next year's budget appropriation. *Id.* at 205-06.

46. *Id.* at 207. In addition, the Court declined to find that the creditor would be delayed in enforcing his claims by the added requirement of placing a copy of his judgment on file with the city controller. *Id.* See note 45 *supra.*

to collect his debt from the city had not been shown to disadvantage the creditor: his expectations of enforcement under the present statute were no less than under the legislation in effect when the creditor-debtor relationship was formed.[47] Accordingly, no impairment resulted from the challenged legislation.

The 1934 case of *Home Building & Loan Association v. Blaisdell*[48] has been described as a watershed in the history of the interpretation of the contract clause.[49] However, while *Blaisdell* gave new emphasis to the state's police power as a factor in the analysis,[50] an examination of the post-1934 cases suggests that the decision had little effect on the evolving definition of impairment. *Faitoute Iron & Steel Co. v. City of Asbury Park*[51] clearly indicates that the Court continued to employ the same practical approach toward what constitutes an impairment as had been developed in the earlier cases.[52] Though a concern for the

47. 102 U.S. at 207.

48. 290 U.S. 398 (1934).

49. "The *Blaisdell* opinion . . . amounted to a comprehensive restatement of the principles underlying the application of the Contract Clause . . . ." City of El Paso v. Simmons, 379 U.S. 497, 508 (1965); *see* B. WRIGHT, *supra* note 3, at 109.

Justice Sutherland, writing in a vehement but scholarly dissent to *Blaisdell*, summarized his view of its import as follows:

> Few questions of greater moment than that just decided have been submitted for judicial inquiry during this generation. He simply closes his eyes to the necessary implications of the decision who fails to see in it the potentiality of future gradual but ever-advancing encroachments upon the sanctity of private and public contracts. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 448 (1934) (Sutherland, J., dissenting).

One way in which *Blaisdell* affects subsequent judicial interpretation is by diminishing the importance in contract clause analysis of any historical review of the reasons which led to adoption of the contract clause. In accord with previous historical studies, the Court acknowledged that the contract clause undoubtedly was meant to deal with the type of state legislation which had led to a critical undermining of credit in the post-revolutionary period, when the states protected debtors by defeating creditors' contractual rights. *Id.* at 427 (majority opinion). However, it found in the line of decisions interpreting the contract clause "a growing appreciation of public needs and of the necessity of finding ground for a rational compromise between individual rights and public welfare." *Id.* at 442. The Court, therefore, denied that "what the provision of the Constitution meant to the vision of that day it must mean to the vision of our time," *id.*, though the Moratorium Act which the Court upheld was essentially legislation protecting debtors at the expense of creditors' literal contract rights—the same type of legislation as that which troubled the framers of the Constitution.

For an historical inquiry into the original purposes of the contract clause, *see, e.g.*, Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 197 (1819); B. WRIGHT, *supra* note 3, at 4-16.

50. While prior cases were concerned primarily with "remedial changes," *Blaisdell* employed the police power rationale to sustain "a Minnesota statute which seemed, by the Court's own standards, to do more than alter the remedy." B. WRIGHT, *supra* note 3, at 109. The case is discussed at notes 123-27 *infra* and accompanying text.

51. 316 U.S. 502 (1942).

52. *See also* W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935):

state's police power is implicit in the *Faitoute* opinion,[53] the Court apparently concluded as a factual matter that no impairment resulted from the challenged state legislation.[54]

The facts of *Faitoute* are crucial to an understanding of the Court's standard for determining when an impairment exists. At issue in the case was a New Jersey statute authorizing state control over insolvent municipalities.[55] Pursuant to this statute the finances of Asbury Park were placed under control of a state commission at the instance of some of the city's creditors.[56] Thereafter a plan providing for a refund of the outstanding unsecured bonds and an exchange of that indebtedness for new bonds with extended maturity and a lower interest rate was approved by the commission and consented to by bondholders representing eighty-five percent of the amount of indebtedness affected.[57]

In *Faitoute* the Supreme Court held that the claim of non-consenting bondholders for the value of the defaulted old bonds and coupons had been legitimately precluded by the state legislation. In upholding the constitutionality of the statute the Court's analysis centered on whether the value of the bondholders' contract had been reduced not merely in theory but in practice.[58] The Court was particularly impressed with how "empty" the unsecured bondholders'[59] remedy had become in the face of Asbury Park's insolvency.[60] It noted that the

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> What controls our judgment . . . is the underlying reality rather than the form of label. The changes of remedy now challenged as invalid are to be viewed in combination, with the cumulative significance that each imparts to all. So viewed they are seen to be an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security. *Id.* at 62.

53. "The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation for the very reason that thereby the obligation is discharged, not impaired." 316 U.S. at 511. *See also id.* at 509-13.

54. *Id.* at 516. Indeed, it was found that the legislation actually *increased* the value of the obligee's claim.

55. *Id.* at 503.

56. *Id.*

57. *Id.* at 506, 507.

58. *Id.* at 514. The Court asked whether the value of the contract had been reduced ". . . in the realm of actualities and not of abstractions and paper rights, of what things are worth in dollars and cents, and in what is proposed to realize paper values." *Id.*

59. The Court was careful to confine its decision to the facts before it, noting specifically that "we are not here concerned with legislative changes touching secured claims." *Id.* at 516.

60. *Id.* at 514. *Cf.* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 425 (1934) wherein the Court stated that "the statute does not impair the *integrity* of the mortgage indebtedness" (emphasis added).

In *Blaisdell* the Court placed overwhelming emphasis on defining the state's "emergency power" and the scope of its proper exercise when existing contracts are

principal asset of a municipality is its power to tax, a power which is "wholly subordinate to the unrestrained power of the State over political subdivisions of its own creation."[61] In addition, the remedy of mandamus, as used to instruct city officials to levy and collect taxes, was seen by the Court as a futile exercise which historically had resulted in the recalcitrant officials' resignation or imprisonment for contempt.[62] In view of this situation, the Court held that to strike down a statute which forced a reasonable composition[63] on non-consenting holders of such bonds would be to conclude, in effect, "that the right to pursue a sterile litigation is an 'obligation' protected by the Constitution of the United States."[64] Thus *Faitoute* reaffirms the pragmatically oriented standard of impairment developed in the early cases and, in applying it, confirms that "a law reducing the scope of what will constitute satisfaction may be valid if it has a compensating effect in strengthening the practical efficacy of the remedy."[65]

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affected. See notes 123-27, 180-83 *infra* and accompanying text. The Court, therefore, assumed that the statute in question caused at least a technical impairment; otherwise there would have been no need to justify it by invoking the police/emergency power doctrine. The observation that the "integrity" of the obligation was not impaired appears in the context of a discussion leading to the Court's finding that the legislature's exercise of its emergency power was "not . . . unreasonable." 290 U.S. at 445.

61. 316 U.S. at 509.

62. "For there is no remedy when resort is had to 'devices and contrivances' to nullify the taxing power which can be carried out only through authorized officials." *Id.* at 511, *citing* Rees v. City of Watertown, 86 U.S. (19 Wall.) 107, 124 (1873). This, said the *Faitoute* Court, was the lesson taught by the depressions of 1873 and 1893. 316 U.S. at 510.

63. The Court contrasted the value-preserving aspects of the composition arrangement complained of in *Faitoute* with the legislation challenged in W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935). In that case, the statute had significantly weakened the process by which bondholders of a municipal improvement district could enforce payment of assessments for their benefit and reduced incentives for property owners to pay their assessments. *Id.* at 60-61. (See note 130 *infra* for a description of the specific statutory alterations.) While in *Faitoute* the bonds were unsecured obligations, existing security in *Worthen* in the form of a remedy against the property of tax delinquents had been adversely affected by the state act. *See* Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 515-16 (1942). While the statute in *Worthen* had resulted in "an oppressive and unnecessary destruction of nearly all the incidents that give attraetiveness and value to collateral security," 295 U.S. at 62, the Court in *Faitoute* found that due legislative regard for creditors' interests had resulted in a composition plan which actually enhanced the value of the bondholders' claims. 316 U.S. at 516.

64. 316 U.S. at 510-11.

65. Hale, *supra* note 3, at 555. The author also interpreted *Faitoute* as requiring generally that:

> The scope of the performance which the obligation calls for must be considered in connection with the efficacy of the means for inducing performance or with the substitute which the law gives for nonperformance, before it can be determined whether any statute impairs the obligation. *Id.*

A corollary of the proposition that an obligation has been impaired when its practical value has been decreased is that an obligation is not impaired by the alteration or even the repeal of a contractual remedy if another remedy exists which affords equally adequate protection for the value of the obligation.[66] One series of cases, collectively known as the "deficiency judgment" cases,[67] however, has gone one step fur-

66. The particular remedy existing at the date of the contract may be altogether abrogated if another equally effective for the enforcement of the obligation remains or is substituted for the one taken away. Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124, 128-29 (1937), *citing* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 434 (1934).

Recognition and oblique articulation of this corollary goes back at least as far as Louisiana v. New Orleans, 102 U.S. 203 (1880), wherein the Court, in upholding the statute involved, see notes 43-47 *supra* and accompanying text, noted that the city's creditor could pursue other remedies for collection which had been left intact by the legislation. 102 U.S. at 207.

Despite its statement of principles consistent with the earlier cases, the *Wachovia* Court found no impairment even though the practical value of the contract to the obligee at the time it was sought to be enforced was apparently decreased by the challenged legislation. The North Carolina statute at issue in *Wachovia* altered a pre-existing statutory scheme which had allowed a mortgagee who purchased his mortgagor's pledged property at a judicial sale to recover as a deficiency judgment the difference between the *price he bid* at the sale and the amount of the debt still owed. The legislative alteration provided that, in an action at law, the mortgagee's deficiency judgment would be determined by the jury on instructions that the deficiency should be limited to the difference between the *fair market value* at the date of sale and the amount of debt yet unpaid. 300 U.S. at 126-27, 129-30. The Court found that the mortgagee's pre-existing rights were adequately protected by the availability of the traditional equitable default-foreclosure remedy. *Id.* at 131; *accord*, Honeyman v. Jacobs, 306 U.S. 539, 543 (1938) (upholding constitutionality of New York statute denying deficiency judgment to purchasing mortgagee when real value of property was equal to debt secured on ground that statute "in substance assured to the court the exercise of its appropriate equitable powers"). The *Wachovia* Court likened the new procedure for obtaining deficiency judgments to the traditional equitable action, noting that the latter does not provide absolute protection for the mortgagee either, because a court of equity normally can refuse to confirm a judicial sale on equitable grounds where the sale was unfair or where an inadequate price was bid. 300 U.S. at 131. *See also* Honeyman v. Jacobs, 306 U.S. 539 (1938) (same characterization of foreclosure action in equity).

As a general proposition, however, the equitable remedy is probably considerably less favorable to the mortgagor than the Court suggested. *See* 4a COLLIER ON BANKRUPTCY ¶ 70.98[17], at 1180-92, 1187-93 (14th ed. 1962). *See also* Gelfert v. National City Bank, 313 U.S. 221, 232 (1941) (recognizing the carefully restrained character of the equitable action for a deficiency judgment). Moreover, even if the challenged statute preserved a remedy which was coextensive with the traditional equitable process, neither remedy would have given the mortgagee the protection and advantage of the statute which existed at the time the mortgage was executed. That earlier statute—one which had no practical obstacle to its use at the time the mortgagee sought to enforce his remedy—placed the risk of obtaining a poor price at a judicial sale (whether because of a depressed economy or otherwise) on the mortgagor. Neither the altered legislative scheme nor the action at equity, even as characterized by the Court, preserved this risk allocation, a feature of the contract which gave it extra value to the mortgagee. Hence, though *Wachovia* purported to apply well established principles, its result seemingly allows a literal impairment of the mortgagee's contract rights.

67. Gelfert v. National City Bank, 313 U.S. 221 (1941); Honeyman v. Jacobs, 306

ther and permitted alteration of an obligee's remedy even though the new remedy is less desirable than the old, so long as the altered remedy still allows recovery of as much or more than the obligee could have obtained if the contract had been fully performed.[68] More particularly, the deficiency judgment cases sanctioned state legislation designed to reduce or eliminate the advantage which accrued to mortgagees during the Great Depression as a result of drastically depressed prices of real property. The effect of the Court's decision in each case was to allow states to prevent mortgagees from taking advantage of the allocation of risks, as prescribed at the time of the making of the contract, which were to obtain in case of the mortgagor's default.[69] The Court explicitly refused to "dignify into a constitutionally protected right [the mortgagees'] chance to get more than the amount of their contracts,"[70] insisting that "mortgagees are constitutionally entitled to no more than payment in full."[71] Thus, if the holding of the deficiency judgment

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U.S. 539 (1939); Honeyman v. Hanan, 302 U.S. 375 (1937); Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937).

68. Hale, *supra* note 3, at 551.

69. The facts of Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937) are discussed in note 66 *supra.*

In the next deficiency judgment case to reach the Supreme Court, Honeyman v. Hanan, 302 U.S. 375 (1937), a statute was upheld which provided that during an emergency period an action to recover a deficiency judgment for indebtedness secured by a mortgage could not be maintained after the mortgaged premises were sold unless the right to the deficiency judgment were determined in the foreclosure action. *Id.* at 377. Hence, since the right to a deficiency judgment was to be determined before the judicial sale, the question whether there was to be an additional recovery had to be decided on the basis of the "value" of the mortgaged property, not on the amount it would bring at a judicial sale, as would have been the case under the former legislation.

Honeyman v. Jacobs, 306 U.S. 539 (1939), involved a review of a New York statute denying a mortgagee who purchased at a foreclosure sale the right to a deficiency judgment when the state court found that the real value of the property sold was equal to the debt secured by the mortgage. *Id.* at 540-41. The constitutionality of the statute was upheld on the rationale that it "in substance assured to the court the exercise of its appropriate equitable powers." *Id.* at 543.

Finally, in Gelfert v. National City Bank, 313 U.S. 221 (1941), the Court upheld a non-emergency statute which denied a mortgagee who purchased at a foreclosure sale the right to a deficiency judgment when the value of the property was found to be equal to the debt secured by the mortgage. The statute applied to all actions for a deficiency judgment and the Court agreed that no remedy existed which was "substantially coextensive" with the pre-existing laws basing calculation of the amount of deficiency due on the price the property brought at a judicial sale. *Id.* at 229-30.

70. Gelfert v. National City Bank, 313 U.S. 221, 234 (1941).

71. *Id.* at 233; *accord,* Honeyman v. Jacobs, 306 U.S. 539, 542-43 (1939). *See also* Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937):

> The act alters and modifies one of the existing remedies for realization of the value of the security, but cannot fairly be said to do more than restrict the mortgagee to that for which he contracted, namely, payment in full. *Id.* at 130.

cases, read in conjunction with *Faitoute*, is generalized, an impairment will be found only if a remedy is altered to such an extent that the complaining party's recourse is less practically efficacious *and* is of less value than actual performance of the contract.[72]

In light of this formulation, it is now possible to analyze the two recent cases described at the beginning of this section.[73] In *Patterson v. Carey*,[74] the toll rollback from twenty-five to ten cents for a maximum period of 120 days was alleged to be an impairment of a contract which empowered a State Parkway Authority to charge and collect tolls for the benefit of the Authority's bondholders. Though the bonds were to be paid from parkway revenues, the trial court had found that the loss of revenue occasioned by the 120-day rollback would not "endanger the security of the bonds or precipitate a default. . . ."[75] The Appellate Division concluded, nevertheless, that the state's infringement on the power of the Parkway Authority to set tolls according to its own determination of needs and obligations constituted an impairment.[76] Under the practical value definition of impairment, the court's conclusion seems to have been based on insufficient evidence. The rollback imposed constraints on the decision-making power of the Authority which were ephemeral and extremely limited. According to a

72. The deficiency judgment cases have been interpreted as altering the concept that the law of the time and place of the contract's execution becomes a part of the contract:

> [*Honeyman v. Jacobs*] seems to imply a new corollary to the time-honored rule that the law of the time and place where the contract was executed becomes a part of the contract. That is, if the Court finds that a given law (which is deemed part of the contract) imposes an unconscionable burden or gives undue advantage to one of the parties, it will refuse to allow that law constitutional immunity against change. 39 COLUM. L. REV. 1227, 1231 (1939).

Some of the dicta in the deficiency judgment cases, most of them in the inflammatory *Gelfert* opinion, tend to support this interpretation:

> [The legislative formula for determining the amount of a deficiency judgment] which exists at the date of the execution of the mortgage does not become so embedded in the contract between the parties that it cannot be constitutionally altered. Gelfert v. National City Bank, 313 U.S. 221, 231 (1941).
>
> The Federal Constitution does not undertake to control the power of a State to determine by what process legal rights may be asserted or legal obligations be enforced, provided the method of procedures gives reasonable notice and affords fair opportunity to be heard before the issues are decided. Honeyman v. Hanan, 302 U.S. 375, 378 (1937), *quoted in Gelfert*, 313 U.S. at 235.

However, case law both before and since the deficiency judgment cases does not comport with this interpretation. For conflicting cases decided prior to the deficiency judgment cases, see note 11 *supra*. The most important of the later cases is City of El Paso v. Simmons, 379 U.S. 497, 508 (1965) (recognizing that "existing laws [are] read into contracts in order to fix obligations as between the parties").

73. See notes 16-28 *supra* and accompanying text.

74. 52 App. Div. 2d 171, 383 N.Y.S.2d 414 (1976).

75. *Id.* at 176, 383 N.Y.S.2d at 417.

76. *Id.*

finding of fact accepted by the court, the state's superimposed decision regarding the toll rate did not result in a reduction of the value of the bondholders' contract rights.[77] Thus the court's finding of impairment could not have rested on the substance of the legislative directive, but must have been prompted by the bare fact that the Authority's decision-making power had been overridden in technical violation of the state's agreement.[78] There was no mention by the court of any effect on the actual value of the bonds which resulted from the temporary removal of the Parkway Authority's rate-setting discretion. Absent such a showing, the mere formal alteration of a contract right[79] by a state should not be subject to contract clause challenge.[80] As to the provision of the challenged legislation requiring a 120-day waiting period for review and public hearings before any future toll increase could be implemented by the Authority,[81] the court found that these requirements did not affect the Parkway Authority's "ultimate and unfettered power" to determine toll charges.[82] The court's argument for impairment on the sole basis of a change in the Authority's powers was therefore inapplicable to the review-period provision. In addition, the court determined that the security of the bonds was not affected by this portion of the law because the final toll charge arrived at by the Authority could take into account delay in implementation.[83] Given these findings,[84] the court's conclusion that the review-period provision did not impair bondholders' contract rights is consistent with the practical impact approach to impairment.

The issue in *United States Trust Co. v. New Jersey*,[85] as previously noted,[86] was whether an impairment was effected by repeal of a legis-

77. *Id.* at 178, 383 N.Y.S.2d at 419. See notes 91-93 *infra* and accompanying text for a discussion of the relationship between reduction of contract security and impairment.

78. 52 App. Div. 2d at 175, 383 N.Y.S.2d at 416.

79. *See* City of El Paso v. Simmons, 379 U.S. 497, 515-17 (1965). See notes 136-48 *infra* and accompanying text.

80. *See* Louisiana v. New Orleans, 102 U.S. 203, 207 (1880). See notes 45-47 *supra* and accompanying text.

81. 52 App. Div. 2d at 177, 383 N.Y.S.2d at 418-19.

82. *Id.* at 178, 383 N.Y.S.2d at 419.

83. *Id.*

84. If this review-period delay were significantly lengthened, it would seem that the flexibility of the Authority to respond to changing needs would be so restricted as to endanger the value of the bonds. It is unclear from the opinion whether the court might have reached a different result had the review period been longer.

85. 134 N.J. Super. 124, 338 A.2d 833 (1975), *aff'd* 69 N.J. 253, 353 A.2d 514, *prob. juris. noted*, 96 S. Ct. 3188 (1976).

86. See notes 23-28 *supra* and accompanying text.

lative convenant with bondholders of the Port Authority of New York and New Jersey which had limited use of the revenues of the Port Authority to preclude support of certain passenger railroads if the Authority's losses exceeded a certain permitted deficit.[87] It is clear that the repeal of the covenant would have constituted an impairment if its operation had prevented the bonds or their coupons from being paid.[88] As the case came to trial, interest on the bonds was continuing to be paid and the principal obligations were not yet due;[89] these facts alone, however, were not determinative of whether the continuing value of the obligations would be lessened or whether they would be worth less at maturity. The New Jersey Superior Court did not make an explicit finding on these issues, though it conceded "the existence of some impairment of bondholder security as a result of the repeal."[90]

The ultimate value of the contract measured in terms of its future performance or enforceability would seem to depend on the only available present measure of that value—the practical likelihood that the obligation would be met.[91] The precedents already discussed indicate that a contract's security provisions may be altered to the obligee's detriment so long as replacement security of equal value is substituted.[92]

87. 134 N.J. Super. at 161-63, 338 A.2d at 854-55. The "permitted deficit" was defined as an amount not exceeding (A) the amount of passenger railroad deficit which New York or New Jersey was willing to guarantee, plus (B) the greater of (1) an amount equal to ten percent of the general reserve fund less an amount equal to one percent of the Authority's bonds outstanding which were issued for passenger rail purposes, or (2) an amount equal to ten percent of the amount calculated under clause (1) plus one percent of the Authority's equity in all facilities other than passenger rail facilities. *Id.* at 162-63, 338 A.2d at 855.

88. In Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535 (1866), the Court held that there had been an impairment on a finding that as a result of state legislation the city could not collect sufficient taxes to pay the bond debt. *Id.* at 554. See notes 37-42 *supra* and accompanying text.

89. Moody's and Standard and Poor's continued to rate Authority bonds as "A" bonds even after repeal of the covenant. 134 N.J. Super. at 179, 338 A.2d at 864.

90. *Id.* at 195, 338 A.2d at 873.

91. In Louisiana v. New Orleans, 102 U.S. 203 (1880), the "security" of the claimant's contract could almost certainly be said to have been threatened by legislation limiting creditors' recoveries to a specific fund set aside in the city budget. *Id.* at 205-06. See notes 45-46 *supra* and accompanying text. The Court nevertheless upheld the statutory alteration since the creditor's immediate opportunity for full recovery was not affected. Obviously, since the bondholders who brought suit in *United States Trust* did not have mature claims for the principal of the Authority's debt, the fact that they may not have been under an immediate disadvantage does not imply the same result as that which obtained in *Louisiana v. New Orleans*.

92. The cases discussing whether or not an impairment has occurred when one of several available remedies has been altered or repealed state that if an alternative remedy remains which affords equally adequate protection there has been no impairment. *See, e.g.*, Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124,

Repeal of the negative convenant in *United States Trust*, however, was unaccompanied by substitution of any additional security.[93] The legislative repeal allowed a reduction of the "general reserve fund"[94] which was pledged as security for payment of interest and principal on the bonds and permitted the Authority's application of revenues to meet passenger railroad deficits.[95] Though Port Authority revenues and reserves had in fact increased in the several years prior to the repeal,[96] such a favorable trend should not qualify as substitute security since it was arguably dependent on the railroad deficit restrictions provided by the negative covenant. Moreover, witnesses at the trial testified that they would not have purchased or recommended purchase of the bonds "at the price which they were then offered" if the legislative covenant had not then been in effect.[97]

Considering all of these factors of valuation, there is little doubt that future performance of the debt obligations was less secure, and the court was therefore justified in concluding that the repeal legislation challenged in *United States Trust* did result in an impairment as that term is used in article I, section 10 of the Constitution. Final disposition of this case must await the Supreme Court's impending interpretation. Nevertheless, as will presently be discussed,[98] this "impairment" should be constitutionally proscribed despite application of the "police power doctrine".

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128-29 (1937); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 430 (1934). See note 66 *supra* and accompanying text. If two types of security were provided in a contract and one type was removed by state legislation, however, it would seem unreasonable to say that the value of the contract had not been diminished. While duplication of remedy in most instances provides an alternative, duplication of security is usually considered cumulative—that is, a contract would be deemed more secure and of greater value merely because of the presence of two types of security, even though each might be valued as equivalent to the other. For example, if a creditor takes a mortgage on two of his debtor's houses, each of equivalent value and each sufficient alone to cover the full amount of the debt, he may be very glad to have the duplicate security when the debtor intentionally burns down one of the houses and the insurance company refuses payment.

93. The legislature provided no substitute for the repealed covenant. United States Trust Co. v. New Jersey, 134 N.J. Super. 124, 338 A.2d 833 (1975), *aff'd*, 69 N.J. 253, 353 A.2d 514, *prob. juris. noted*, 96 S. Ct. 3188 (1976).

94. The covenant had protected the Authority's revenues and reserves from being depleted for the support of passenger railroads operating at a significant deficit. 134 N.J. Super. at 161-63, 338 A.2d at 854-55.

95. *Id.* at 140-41, 338 A.2d at 842.

96. *Id.* at 195, 338 A.2d at 873 n.43.

97. *Id.* at 179, 338 A.2d at 864.

98. See notes 168-78 *infra* and accompanying text. Oral argument in *United States Trust* was heard in November, 1976. 45 U.S.L.W. 3362 (U.S. Nov. 10, 1976).

B. *The Police Power*

Even though state legislation has technically effected an impairment of contractual obligations, an act will not be deemed constitutionally proscribed if it is a proper exercise of the state's police power. The theoretical basis for this judicial analysis was first expressed in *Stone v. Mississippi.*[99] The police power exception was supported as a means of preserving for the states the governing power entrusted to them by the people. It was recognized that the states possessed "discretion . . . in respect to matters the government of which, from the very nature of things, must 'vary with varying circumstances.' "[100] Since *Stone v. Mississippi*, the justification for allowing exercise of the "protective power of the State"[101] even when the value of an existing contract is thereby reduced has been variously expressed as: a recognition that the state cannot bind itself to a course of action which is deleterious to its inhabitants' peace, good order, health or morals;[102] a declaration that all contracts are written subject to the implied con-

99. 101 U.S. 814 (1879).

100. *Id.* at 820; *see* Denver & Rio Grande R.R. v. City of Denver, 250 U.S. 241, 244 (1919); Atlantic Coast Line R.R. v. City of Goldsboro, 232 U.S. 548, 558 (1914); Butchers' Union Slaughter-house Co. v. Crescent City Live-stock Landing Co., 111 U.S. 746, 751 (1884).

In *Stone v. Mississippi*, legislation outlawing lotteries was challenged by a business which the previous year had been chartered to run a lottery. It was the first case to rest a decision upholding a state statute on the doctrine of inalienability of the state's police power. Two prior Supreme Court cases, however, laid the groundwork for establishing the principles of the police power doctrine, though their holdings were based on other analyses. *See* Beer Co. v. Massachusetts, 97 U.S. 25 (1878); Boyd v. Alabama, 94 U.S. 645 (1877). *See generally* Merrill, *supra* note 6.

Even earlier, efforts to suggest that the police power might serve as an excuse for allowing states to renege on obligations they had made had been rebuffed by the Court. For example, in *The Binghamton Bridge*, 70 U.S. (3 Wall.) 51 (1865) the Court said:

> It is argued, as a reason why courts should not be rigid in enforcing the contracts made by States, that legislative bodies are often overreached by designing men, and dispose of franchises with great recklessness.
>
> If the knowledge that a contract made by a State with individuals is equally protected from invasion as a contract made between natural persons, does not awaken watchfulness and care on the part of law-makers, it is difficult to perceive what would. The corrective to improvident legislation is not in the courts, but is to be found elsewhere. *Id.* at 74.

*See also* Wilmington R.R. v. Reid, 80 U.S. (13 Wall.) 264, 266 (1872). One commentator has suggested that the Court's recognition of the primacy of the police power even in the face of a contract clause challenge was encouraged by the abuses of reconstruction legislatures in the South in contracting away the public welfare and by "an awakening sensitiveness at the North to social advancement as against the claims of vested rights . . . ." Merrill, *supra* note 6, at 660.

101. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 440 (1934).

102. Walla Walla City v. Walla Walla Water Co., 172 U.S. 1, 15 (1898); *see* Fertilizing Co. v. Hyde Park, 97 U.S. 659, 667, 670 (1878).

dition of the exercise of the state's police power;[103] a statement that the proper exercise of the police power is a sovereign right of the state which is superior to an individual's contract rights;[104] and an approach which cautions one who enters into contracts in an area of enterprise which is already regulated that his agreements are subject to being affected by further legislation in that area.[105] Whatever its theoretical basis, the doctrine that the contract clause will not bar a proper exercise of state police power is well established.

The Supreme Court has characterized the police power as "the power of the State to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community."[106] The Court has extended the definition to clarify that the police power encompasses protection of the economic welfare of the state,[107] and that this power may be exercised even when economic well-being requires regulation of state political subdivisions' contracts with creditors.[108]

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103. "Our decisions recognize that every contract is made subject to the implied condition that its fulfillment may be frustrated by a proper exercise of the police power . . . ." Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95, 108-09 (1938); *see* East New York Savings Bank v. Hahn, 326 U.S. 230, 232 (1945).

104. East New York Savings Bank v. Hahn, 326 U.S. 230, 232-33 (1945), *quoting* Manigault v. Springs, 199 U.S. 473, 480 (1905). The Court characterized this expression of the police power doctrine as the more "candid statement." 326 U.S. at 232.

105. . . . [W]hen a widely diffused public interest has become enmeshed in a network of multitudinous private arrangements, the authority of the State 'to safeguard the vital interests of its people' . . . is not to be gainsaid by abstracting one such arrangement from its public context and treating it as though it were an isolated private contract constitutionally immune from impairment." East New York Savings Bank v. Hahn, *supra*, at 232 (citation omitted).

*See* Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 38 (1940).

106. Atlantic Coast Line R.R. v. City of Goldsboro, 232 U.S. 548, 558 (1914). This definition has its origins in the classic statement in Stone v. Mississippi, 101 U.S. 814 (1879), that the police power encompasses "the preservation of the public health and the public morals, and the protection of public and private rights." *Id.* at 820. The conceptual basis of state police power in the federal system has been described as "the residuum of governmental powers left to the states after subtracting that delegated to the national jurisdiction . . . ." Merrill, *supra* note 6, at 657.

107. "[State authority to safeguard the vital interests of the people] is not limited to health, morals and safety. It extends to economic needs as well." Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 38-39 (1940). That case dealt with legislation designed to preserve the stability of building and loan associations, "financial institutions of major importance to the credit system of the State." *Id.* at 37.

108. Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 513-14 (1942) (if a state retains police power in the economic realm with respect to building and loan associations, as established in *Veix*, the state certainly should have like power for maintenance of political subdivisions); *cf.* Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 38 (1940).

For the most part, the Court has not segmented the broad state police power so as to set up contract clause barriers to its exercise in any particular areas of its operation. One exception to this general rule is the judicial willingness to allow states to make irrevocable guarantees in the area of state tax exemptions. The Court has consistently held that when a state grants a tax exemption to a corporation or fixes a tax rate for a company, the contract clause prevents subsequent state alteration of the exemption or rate.[109] Though blanket contract clause protection of state tax exemption grants may be viewed as something of an anomaly in the history of the Court's interpretation of the clause,[110] the Court nevertheless has been reluctant to suggest that a state may never bind itself irrevocably in any area which could be affected by its police power.[111] The rationale for refusing to curb a state's partial surrender of the power to tax, "one of the highest and most important attributes of sovereignty,"[112] could, theoretically, be ap-

109. *See, e.g.*, City of Charleston v. Branch, 82 U.S. (15 Wall.) 470 (1872); Tomlinson v. Branch, 82 U.S. (15 Wall.) 460 (1872); Wilmington R.R. v. Reid, 80 U.S. (13 Wall.) 264 (1872); New Jersey v. Wilson, 11 U.S. (7 Cranch) 164 (1812); *cf.* Piqua Branch Bank v. Knoop, 57 U.S. (16 How.) 369 (1854) (premise assumed though decision based on matter of construction).

110. *Compare* B. WRIGHT, *supra* note 3, at 203-13, *with id.* at 179-80. *See also id.* at 209 (stating that the Supreme Court has also generally refused to apply the police power doctrine to statutes abolishing monopolies). Though there have been some seemingly general holdings to the effect that the contract clause protects from subsequent repeal a municipality's agreement not to build or operate municipal utilities, Vicksburg v. Vicksburg Waterworks Co., 202 U.S. 453 (1906); Walla Walla City v. Walla Walla Water Co., 172 U.S. 1 (1898), and that the clause allows states to contract away police power to fix rates for a set period of time, *see* Merrill, *supra* note 6, at 663-64 and cases cited therein, these are isolated instances and the results may sometimes be explained on other grounds. For example, the theory of proper exercise of police power developed in *Walla Walla* suggests that the decision was based on a finding that the state had exercised that power improperly.

111. "[W]e are not prepared to say that the legislature can make valid contracts on no subject embraced in the largest definition of the police power." Butcher's Union Slaughter-house Co. v. Crescent City Live-stock Landing Co., 111 U.S. 746, 750-51 (1884). On the other hand, the Court has been very clear in stating that some state powers, for example the power of eminent domain, may never be contracted away. West River Bridge Co. v. Dix, 47 U.S. (6 How.) 507 (1848) (power of eminent domain). Dicta in Board of Liquidation v. McComb, 92 U.S. 531 (1876), suggest that the state might not be able to bind itself by statute not to create any further debt or not to issue any more bonds, as such an engagement "involves, if binding, a surrender of a prerogative which might seriously affect the public safety." *Id.* at 535. Likewise, a complete surrender of the power to tax by a state might not be enforceable: "No government dependent on taxation for support can bargain away its whole power of taxation, for that would be substantially abdication." Stone v. Mississippi, 101 U.S. 814, 820 (1879).

112. Wilmington R.R. v. Reid, 80 U.S. (13 Wall.) 264, 267 (1872). *But cf.* Stone v. Mississippi, 101 U.S 814, 820 (1879) (complete surrender of state's taxing power impermissible).

plied to almost any manifestation of the police power:

> [T]he courts of the country are not the proper tribunals to apply the corrective to improvident legislation of this character. If there be no constitutional restraint on the action of the legislature on this subject, there is no remedy, except through the influence of a wise public sentiment, reaching and controlling the conduct of the lawmaking power.[113]

Despite the breadth of the police power concept and the doctrine which permits its exercise even when contractual obligations are technically impaired, its use is not unrestricted when pre-existing contract rights are affected. A state's exercise of police power is proper only when "the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."[114] The "legitimate end" to which the legislature must address itself is the protection of a basic interest of society,[115] as distinguished from purely private rights.[116] It is not enough that the legislation merely relate to a subject involving the public interest; the statute must be designed specifically to protect public interests in that area.[117] This judicial determination

113. Wilmington R.R. v. Reid, 80 U.S. (13 Wall.) 264, 267 (1872). In fact, this is exactly the reasoning which the Court did use to turn aside arguments that the states are constitutionally allowed to impair contracts in the exercise of their police power. *See* The Binghamton Bridge, 70 U.S. (3 Wall.) 51, 74 (1865) *quoted in* note 100 *supra*.

114. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 438 (1934); *accord*, Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95, 109 (1938); Treigle v. Acme Homestead Ass'n, 297 U.S. 189, 197 (1936).

115. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 445 (1934); *accord*, Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95, 109 (1938).

116. Treigle v. Acme Homestead Ass'n, 297 U.S. 189, 197 (1936).

117. In Treigle v. Acme Homestead Ass'n, 297 U.S. 189 (1936), for example, a state law was challenged which affected building and loan associations—corporations which the Court characterized as "quasi-public." *Id.* at 197. The act in question gave directors of such corporations broad discretion in protecting members' rights to receive withdrawal payments from the association when fifty percent of the receipts of the associations had previously been required to be set aside to pay withdrawing members. *Id.* at 191-94, 196. The legislation was deemed by the Court to be inadequately adapted to the "legitimate end of conserving or equitably administering the assets in the interest of all members." *Id.* at 197-98. In other words, the legislation was not designed to preserve the economic health of a quasi-public corporation, but was rather a direct effort to alter the mutual rights of creditors and members of the corporation. *Id.* at 195-97. In the view of the Court, "[s]uch an interference with the right of contract cannot be justified by saying that in the public interest the operations of building and loan associations may be controlled and regulated. . . ." *Id.* at 196.

Four years after *Treigle*, another Supreme Court decision, Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940), called into question the continuing validity of *Treigle*. The factual context in *Veix* was similar to that in *Treigle*. *Veix* involved a statutory change whereby withdrawing members' rights were subordinated to payment of matured shares in the association and the members' rights to sue for the withdrawal value were eliminated. *Id.* at 34-35. At first it might be presumed that the same

is similar to the nexus standard governing equal protection clause determinations in areas where a suspect classification is not evident;[118] in both areas of the law, the Court tends to avoid substituting its value judgments for those of the legislature.[119]

This standard is applied by examining the legislative scheme's potential effect on the asserted state goal (already determined to be a proper subject for the exercise of the police power).[120] If that effect fur-

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criticism which led the Court to deny validity to the statute in *Treigle* would also have applied to that in *Veix*, since the statutory alteration in the latter case, by creating preferential rights for continuing association members, appeared also merely to alter private rights in a quasi-public corporation. Without discussing any factual differences between the two cases, however, the *Veix* Court summarily distinguished *Treigle* on its facts, *id.* at 40-41, and reached the conclusion that "certainly the protection of building and loan associations against the catastrophe of excessive withdrawal is, today, within legislative power." *Id.* at 41.

The effect of the legislation in *Treigle* and in *Veix* cannot have been much different, since in both cases the new legislation disadvantaged withdrawing members vis-a-vis continuing association members and others with a contractual interest in the continuing vitality of such corporations. Whether the *Treigle* Court viewed the statutory provisions as too restrictive, 297 U.S. at 195-96 ("the sections in question do not contemplate the liquidation of associations, the conservation of their assets or the distribution thereof amongst creditors and members"), or not restrictive enough, *id.* at 195 ("the provisions respecting the rights of withdrawing members are neither temporary nor conditional"), to effect the purpose of protecting the public economic welfare, the divergent results of *Veix* and *Treigle* point to the difficulty of judging whether the "relief afforded has reasonable relation to the legitimate end to which the State is entitled to direct its legislation." W.B. Worthen & Co. v. Thomas, 292 U.S. 426, 433 (1934); *see* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 445 (1934) (legislative relief "could only be of a character appropriate to that emergency").

118. Just as in the equal protection area there must be a rational relationship between the legislative classification and the asserted legislative end, *see, e.g.*, Eisenstadt v. Baird, 405 U.S. 438, 443 (1972); Graham v. Richardson, 403 U.S. 365, 371 (1971); Morey v. Doud, 354 U.S. 457, 466 (1957), in contract clause analysis there must be a rational relationship between the legislative means and the goal of the exercise of the police power.

119. "[The courts] will not inquire too closely into the motives of the State, but they will not ignore the effect of its action." Graham v. Folsom, 200 U.S. 248, 253 (1906); *see* East New York Savings Bank v. Hahn, 326 U.S. 230, 234 (1945).

In some contract clause cases, both early and recent, the Court has suggested that the "motive" of the legislature should bear on whether its exercise of police power was proper. In Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827), Justice Johnson said that "[I]t is the motive, the policy, the object, that must characterize the legislative act, to affect it with the imputation of violating the obligation of contracts." *Id.* at 291, *quoted with approval in* City of El Paso v. Simmons, 379 U.S. 497, 509 (1965).

The difficulty with this "motive" standard, of course, is that identical legislation passed under identical economic and other public welfare conditions could conceivably receive different treatment depending on the state of mind (if that could be determined) of the people who drafted and voted on it. *See* United States v. O'Brien, 391 U.S. 367 (1968), wherein the Court explains why "[i]nquiries into congressional motives or purposes are a hazardous matter." *Id.* at 383.

120. *Cf.* Walla Walla City v. Walla Walla Water Co., 172 U.S. 1, 15-17 (1898).

thers the legislative end, the statute has met one step of the test to determine whether the police power has been properly exercised.[121] Even if the legislation in question is reasonably related to an acceptable public end, its provisions must also reflect legislative moderation. This requirement of a spirit of moderation has been said to arise from the necessity of construing the scope of the police power in harmony with the "fair intent" of the contract clause limitation.[122]

Of course, the problem of reconciling the breadth of state police power with the restrictions imposed on state action by constitutionally protected individual rights is not unique to contract clause decisions. In the first amendment and due process areas, for example, the Court has developed similar tests which give latitude to asserted state interests while at the same time attempting to give effect to constitutional pronouncements protecting individual rights. Development of such a test requiring moderate exercise of state police power when contracts are thereby affected began as a process of defining limits beyond which a legislature cannot go in altering contractual obligations.

The seminal case of *Home Building & Loan Association v. Blaisdell*[123] set one limit of legitimate state legislative activity when it insisted that the contract clause "precludes a construction [of state power] which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them."[124] In *Blaisdell*, however, the spirit of moderation was held to have been honored in the statute at issue which extended mortgagors' redemption rights and called a moratorium on foreclosures for a period of not more than two years.[125] The Court was impressed that the legislation did not ignore the interests of mortgagees; because the mortgagor was required to pay rent while he remained in possession during the redemption period, the mortgagee remained entitled to a deficiency judgment and the "integrity of the mortgage indebtedness" was preserved.[126] In sum, the Court found that "the relief afforded by the statute has regard to the interest of mortgagees as well as to the interest of mortgagors."[127]

121. See note 114 *supra* and accompanying text.

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

123. 290 U.S. 398 (1934). See note 49 *supra*.

124. 290 U.S. at 439; *accord*, W.B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934). The *Blaisdell* Court did recognize, however, that a temporary restraint of contract enforcement might be "within the range of the reserved power of the State to protect the vital interests of the community." 290 U.S. at 439; *see also id.* at 445.

125. The legislation was enacted in 1933 and, by its terms, could not remain effective beyond 1935. 290 U.S. at 415-16.

126. *Id.* at 445.

127. *Id.*

In a subsequent case, the Supreme Court did void a state statute on the ground that the legislative moderation which the contract clause demands was disregarded. Challenged in *W.B. Worthen Co. v. Kavanaugh*[128] was legislation effecting procedural changes in the means by which holders of municipal improvement district bonds could enforce payment of mortgage-secured assessments made on property within the district.[129] What had formerly been a summary enforcement process was statutorily altered to extend over a minimum of six and one-half years.[130] In sustaining the constitutional challenge, the Court stated what it considered to be the least demanding standard of moderation required for protection of the victim of an impairment.[131] The Court held that even when public welfare was arguably served by contract-impairing legislation, the bounds of moderation were certainly passed when the statute suggested "studied indifference to the interests of the mortgagee or to his appropriate protection" which resulted in a removal from the obligee's contract of "the quality of an acceptable investment for a rational investor."[132]

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128. 295 U.S. 56 (1935).

129. The municipal improvement district was organized under Arkansas law and was empowered to issue bonds and to mortgage benefit assessments as security for them. The bearer bonds in question were so secured and the mortgage was accompanied by a copy of the assessment of benefits stating in detail the amount of the benefits assessed against each piece of property in the district. *Id.* at 57. The case arose when, after the municipal district had defaulted on the bonds, the trustee for the bondholders and representative bondholders brought suit to foreclose the assessments on lots of delinquent owners. *Id.*

130. The Arkansas legislature passed three laws altering the plan to enforce payments of assessments. Among the procedural changes were the following:

—The time allowed for payment after notice to the taxpayer was extended from thirty days to ninety days.

—The penalty for non-payment was reduced from twenty percent to three percent.

—The time allotted to appear and answer after notice was extended from five days to six months.

—The time allowed for the case to be made ready for hearing was extended from fifteen days to six months.

—The decree could allow the taxpayer twelve months for payment instead of the previously allotted ten days. Thereafter the property could not be sold for six months whereas a hiatus of only twenty days was provided under prior law.

—Under both statutes the property could be redeemed but the later statute changed the interest rate charged from twenty percent to six percent.

—The section which had allowed the purchaser of the property to go into possession for the redemption term without accountability for rents if the redemption should occur was repealed. *Id.* at 58-59.

The Court found that the newly required enforcement process would take a minimum of six and one-half years (including the redemption period). *Id.* at 61.

131. *Id.* at 60.

132. *Id.*

*Blaisdell* and *Worthen* served only to set the constitutional limits of a legislature's ability to impair contracts in the exercise of its police power.[133] Working within these limits, *City of El Paso v. Simmons*[134] included an extensive discussion of the nature of the required spirit of moderation. The Court examined the effect of legislative interference on rights of contracting parties and inquired whether the state had interfered with such rights to an extent greater than that needed to meet its police power goals.[135]

In *El Paso*, the Court considered the obligations arising under a long-term contract for the sale of land by the state of Texas. The contract specified means by which purchasers who defaulted and forfeited land back to the state could have their claims reinstated at any time, unless the rights of third parties had intervened.[136] In order to deter speculation in mineral rights by use of the reinstatement provision, Texas later passed a law limiting to five years the time in which reinstatement rights under such contracts could be exercised.[137]

The *El Paso* Court apparently assumed that the buyer's contract rights were impaired by the legislation, in the sense of being reduced in value,[138] and acknowledged the police power doctrine and its "reasonable and appropriate" requirement.[139] In evaluating the severity of the legislation's impact on the real estate purchasers' original con-

133. *See id.*

134. 379 U.S. 497 (1965).

135. *Id.* at 509-17.

136. See text accompanying note 148 *infra*.

137. 379 U.S. at 499. Under the statute, "forfeited purchase contracts which had remained dormant for years could be reinstated if and when the land became potentially productive of gas and oil." *Id.* at 512.

138. *Id.* at 508. The Court explicitly assumed "the provision for reinstatement after default to be part of the State's obligation . . . ." *Id.* The Texas Court of Appeals had determined on the basis of Texas law that the statute in question effected "a change in the obligation of a contract," *id.* at 505-06, and concluded on the basis of that finding that the law violated the contract clause. *Id.* at 506. By accepting the Texas court's state law conclusion, the Supreme Court implicitly accepted the finding of an "impairment" in the reduction in value of the contract to the obligee. The Court nevertheless found error in the lower court's failure to consider the effect of the state's police power in determining whether the impairment was constitutionally proscribed. The Court was careful to emphasize, immediately after accepting the state court's interpretation of Texas law, that the contract clause "prohibition is not an absolute one." *Id.* at 508, *quoting* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 428 (1934).

Compare the dissent of Justice Black in *El Paso*, 379 U.S. at 528-35, wherein he interpreted the opinion of the Court as acknowledging that there had been an impairment but as giving effect to the legislation because "this impairment [did] not seem to the Court to be very serious or evil . . . ." *Id.* at 521 (Black, J., dissenting).

139. *Id.* at 508-09, *quoting* East New York Savings Bank v. Hahn, 326 U.S. 230, 233 (1945). See notes 114-21 *supra* and accompanying text.

tract rights, the Court first determined that the promise of unlimited opportunity for reinstatement could not have been "the central undertaking of the seller nor the primary consideration for the buyer's undertaking."[140] This conclusion was supported primarily by the fact that at the time the parties executed the contract, reinstatement rights could not have been conceived of as an "endless privilege" because it was the state's policy to sell forfeited land as quickly as possible.[141] Moreover, the speculative value of maintaining an interest in land until its value increased with the discovery of mineral deposits was viewed by the Court as an "unforeseen" benefit which accrued to the purchaser over the years.[142] The speculative nature of this portion of the consideration received was emphasized because "laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the Contract Clause."[143] Taking into account both of these factors, the Court found that the five-year period allotted for a defaulting buyer's reinstatement reasonably protected whatever rights the buyer contemplated acquiring.[144] Thus, the Court concluded that the statute temporally limiting reinstatement "was a mild one indeed, hardly burdensome to the purchaser who wanted to adhere to his contract of purchase. . . ."[145]

A further factor considered in determining whether the real estate

140. 379 U.S. at 514. In his dissent, Justice Black severely criticized the Court's conclusion that the reinstatement rights were not of central importance to the buyers:

> To my way of thinking it demonstrates a striking lack of knowledge of credit buying and selling even to imply that these express contractual provisions safeguarding credit purchasers against forfeitures were not one of the greatest, if not the greatest, selling arguments Texas had to promote purchase of its great surfeit of lands. The Court's factual inference is all the more puzzling since its opinion emphasizes that many people entered these contracts for speculative purposes which without the redemption provision would not have been nearly so attractive. *Id.* at 530 (Black, J., dissenting).

141. *Id.* at 515.

142. *Id.*

143. *Id.* The Court supported this proposition by citing several of the deficiency judgment cases, including Honeyman v. Jacobs, 306 U.S. 539 (1939), and Gelfert v. National City Bank, 313 U.S. 221 (1941). While the deficiency judgment cases do confine an obligee to a remedy which is of a value no greater than he would have gained by his obligor's performance, see notes 67-72 *supra* and accompanying text, they do not fully support the *El Paso* Court's proposition that contracting parties may be allowed to avoid performance which becomes more burdensome than that which was originally foreseeable without a contract clause violation, *see* 379 U.S. at 515. The cases are distinguishable, however, as *El Paso* sets a staudard for legislative moderation, while the deficiency judgment cases define what will be considered a technical impairment.

144. "The five-year limitation allows defaulting purchasers with a bona fide interest in their lands a reasonable time to reinstate. It does not and need not allow defaulting purchasers with a speculative interest in the discovery of minerals to remain in endless default while retaining a cloud on title." *Id.* at 516-17.

145. *Id.* at 517.

purchasers were treated with "studied indifference" was that in light of the state's interest in cutting short the period of reinstatement,[146] "a statute of repose was quite clearly necessary."[147] Obviously, if the legislature interferes with contractual obligations only to the extent "clearly necessary" for the protection of state interests, it is acting as moderately as its asserted public goals allow. In searching for this type of correlation between legislative means and ends, it is apparent that the Court may inquire whether alternative means which would impose a lesser impairment are available to the state. In *El Paso* the legislation was not only "reasonable and appropriate," but also was uniquely related to a proper state end since the impairment it caused was "quite clearly necessary." This showing that the legislature had interfered with contract rights only to the extent necessary to achieve its police power goals, along with the evidence that the effect of such interference on the purchaser's interests was in fact "mild," form the basis of the *El Paso* Court's conclusion that the state's action reflected appropriate legislative moderation.[148]

In both *Patterson v. Carey*[149] and *United States Trust Co. v. New Jersey*[150] the respective defendants argued that the police power doc-

146. The Court described the state's objectives in enacting the legislation as (1) obtaining revenues for the school fund, (2) efficient utilization of public lands, and (3) encouraging compliance with contracts of sale—goals much different from the original objective of encouraging settlement of land which prompted the state to grant unlimited reinstatement rights to buyers. *Id.* at 516.

147. *Id.*

148. In his dissent in *El Paso*, Justice Black compared the majority's analysis to the balancing of individual rights against state interests which the Court uses in fourteenth amendment due process cases. *Id.* at 528-35 (Black, J., dissenting); *cf.* Hale, *The Supreme Court and the Contract Clause* (pt. 3), 57 HARV. L. REV. 852, 890 (1944) (suggesting even before *El Paso* that there was a "tendency for the contract clause and the due process clause to coalesce"). *See also* Funston, *supra* note 3, at 358-59. Justice Black considered that the Court had relied exclusively on "due process" balancing to the exclusion of any other standard for determining whether an exercise of the police power was "proper" in light of the contract clause. 379 U.S. at 521. However, the majority did make conclusory statements as to the "reasonable relationship" between the legislation and the appropriate state purpose of safeguarding economic welfare. More importantly, the majority acknowledged the validity of that standard through its quotation of the earlier cases. *Id.* at 508 (quoting extensively from *Blaisdell*, which the Court characterizes as "a comprehensive restatement of the principles underlying the application of the Contract Clause"). Rather than conclude that *El Paso* impliedly overrules the police power analysis of every contract clause decision since *Blaisdell*, *id.* at 521-22 (dissent of Black, J.), it is consistent with precedent to assume that *El Paso*'s "due process" balancing was an attempt to elaborate on the spirit-of-moderation limitation referred to just prior to the discussion of the parties' respective interests. *Id.* at 509.

149. 52 App. Div. 2d 171, 176, 383 N.Y.S.2d 414, 418 (1976).

150. 134 N.J. Super. 124, 192-98, 338 A.2d 833, 872-75 (1975), *aff'd per curiam*, 69 N.J. 253, 353 A.2d 514, *prob. juris. noted*, 96 S. Ct. 3188 (1976).

trine justified the challenged legislative acts. In *Patterson* the New York court held that the toll rollback was *not* reasonable and appropriate to the legislative end on the basis of which it was sought to be justified.[151] Representatives of the state argued that the toll rollback had been enacted for the purpose of relieving the traffic congestion on local streets which would result from motorists' attempts to avoid paying the increased toll.[152] Since the rollback was effective only for a period of 120 days the court found that the statute was related not to solving the asserted problem,[153] but merely to postponing it. If the ultimate state purpose was, in fact, the efficient operation of a system of roads,[154] no showing was made that allowing 120 days for reconsideration before implementing the toll increase would relate to that purpose. The conclusion of the majority was warranted because the state's means did not appear to be directed to appropriate ends.

In the *United States Trust Co.* case, the challenged repeal of the legislative covenant with Port Authority bondholders was defended on the grounds that for fifty years New York and New Jersey had legislated to coordinate public and private transportation in the public interest,[155] and that the public welfare demanded mass transit facilities to help reduce air pollution and to alleviate the energy crisis.[156] Though the statute did not state a legislative intent to protect citizens' health, safety and welfare,[157] such a statement of supporting rationale is unnecessary,[158] especially since the courts avoid putting legislative motive in issue.[159] Legislation which makes available more money for mass transit[160] clearly appears to be reasonably related to the asserted goals

151. 52 App. Div. 2d at 176-77, 383 N.Y.S.2d at 418.

152. *Id.*

153. *Id.*

154. The dissenting judge in *Patterson* agreed that the price rollback merely postponed the problem, but suggested that the requisite reasonable relationship could be found between the statute and what he perceived as the state's goal of providing an interim during which a determination could be made as to whether the toll increase would be in the public interest. *Id.* at 179, 383 N.Y.S.2d at 420 (Mahoney, J., dissenting). It is unclear, however, whether providing a longer time for weighing the merits of proposed action is a proper goal of the police power.

155. 134 N.J. Super. at 194, 338 A.2d at 873.

156. *Id.* at 173-76, 338 A.2d at 861-63.

157. The intent and purpose of the act as stated therein was merely to repeal "the covenant effectively preclud[ing] sufficient Port Authority participation in the development of a public transportation system in the port district." 1974 N.J. Laws, ch. 25, § 1; *see* 134 N.J. Super. at 171-72, 338 A.2d at 860.

158. Gelfert v. National City Bank, 313 U.S. 221, 235 (1941); United States Trust Co. v. New Jersey, 134 N.J. Super. at 195 n.44, 338 A.2d at 873 n.44.

159. For a discussion of the difficulty of analyzing the legislative motive, see note 119 *supra.*

160. The effect of the repeal of the statute was to allow the Port Authority to invest

of alleviating pollution and energy problems.[161] Moreover, legislating means of providing for public services such as mass transit has traditionally been considered to be within the scope of the police power.[162]

Having disposed of the reasonable and appropriate test, the New Jersey court considered whether the legislative approach was acceptably moderate. Applying the *Worthen* standard,[163] the court found that abrogation of the legislative covenant did not destroy the quality of Port Authority bonds as an "acceptable investment for a rational investor."[164] This conclusion was supported by evidence that Moody's and Standard and Poor's did not alter their "A" ratings of the bonds after the repeal of the covenant,[165] and by the fact that no witness was willing to testify that he would not have purchased the bonds absent the covenant.[166]

The *Worthen* moderation standard, however, establishes only the most lenient test for assessing the validity of state legislation.[167] Judged in terms of the analysis developed in *El Paso*, the case for a finding that the legislature acted moderately is much weaker.

In *United States Trust* there was less evidence than in *El Paso* that the affected obligation was not the "primary consideration for the buyer's undertaking."[168] Though investors apparently would have purchased Port Authority bonds in the absence of the restrictive covenant,[169] there was testimony which strongly suggested that some part of

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in additional passenger railroad operations even though such operations might create a deficit. By 1973 the financial situation of the Port Authority's passenger train operations was such that the Authority was precluded from pledging any of its revenues or reserves to another deficit passenger railroad operation. 134 N.J. Super. at 165, 338 A.2d at 856.

161. The existence of this relationship was supported by statements (of which the New Jersey Superior Court took judicial notice) taken from federal and state legislation and from reports of agencies commissioned by the state. *Id.* at 173-75, 338 A.2d at 861-62.

162. *Cf.* Denver & Rio Grande R.R. v. City of Denver, 250 U.S. 241 (1919); Chicago & Alton R.R. v. Tranbarger, 238 U.S. 67 (1915); Atlantic Coast Line R.R. v. City of Goldsboro, 232 U.S. 548 (1914). *See generally* Wabash R.R. v. Defiance, 167 U.S. 88 (1897).

163. W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 60 (1935). See text accompanying notes 131-32 *supra.*

164. 134 N.J. Super. at 195-97, 338 A.2d at 873-74.

165. *Id.* at 179, 338 A.2d at 864.

166. *Id.*

167. W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 60 (1935).

168. City of El Paso v. Simmons, 379 U.S. 497, 514 (1965).

169. 134 N.J. Super. at 179, 338 A.2d at 864. Based on this evidence alone, the New Jersey court concluded that, although reliance existed, the covenant could not be said to have been "primary consideration for purchase of the bonds." This conclusion is not supported by *El Paso*, in which the Court concluded that the purchasers could not

the consideration was paid for that legislative agreement.[170] Also, no events had intervened between the time of the contract's execution and the time of the covenant's repeal to give the bondholders unexpected benefits. Thus, unlike in *El Paso*, the repeal legislation could not be characterized as a means of merely "restrict[ing] a party to those gains reasonably to be expected from the contract."[171]

In addition, the facts evident from the New Jersey court's opinion do not reveal that repeal of the covenant was "quite clearly necessary" for achieving the state's public welfare goals. As in *El Paso*,[172] the state's interests had changed somewhat during the interim between the making of the contract and its legislative alteration.[173] Though the

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rationally have paid *anything* for the perpetual reinstatement rights they were claiming because state policies at that time assured that their reinstatement rights would be of short duration. City of El Paso v. Simmons, 379 U.S. 497, 514-15 (1965). In other words, in *El Paso* a right was found not to be primary consideration when there could have been, at the time of execution of the contract, no realistic expectation of the right which was abrogated. That case is not precedent for the New Jersey court's standard, which apparently judged not whether the asserted right was *primary* consideration, but whether it was the *only* consideration, for the evidence was clear that without the covenant the bonds would have brought a lower price. 134 N.J. Super. at 179, 338 A.2d at 864.

170. Witnesses testified that they would not have purchased or recommended purchase of the bonds "at the price which they were then [at the time of issuance] offered." 134 N.J. Super. at 179, 338 A.2d at 864.

Moreover, evidence as to whether the secondary market for the bonds was affected by the repeal was inconclusive. *Id.* at 180-82, 338 A.2d at 865. The difficulty of proving that the market price of the bonds was affected *solely* by repeal of the covenant is obvious. The court found that "immediately following repeal and for a number of months thereafter the market price for Port Authority bonds was adversely affected." *Id.* at 180, 338 A.2d at 865. However, the evidence also suggested that the market decline was not permanent since by the time of trial the market price differential between New York-New Jersey Port Authority bonds and Massachusetts Port Authority bonds had narrowed again to what it had been before the repeal. *Id.* The court also relied on evidence that the bond price was affected by adverse publicity related to the financial status of the Port Authority in the Wall Street Journal and New York Times. These articles did not appear until August and November, respectively, however, while the repeal legislation was passed in April. *Id.*

In making light of the importance to bondholders of the negative covenant, the court also noted that the interest rates for Port Authority bonds issued subsequent to repeal of the restrictive covenant were not higher than the rates on the series issued after enactment of the legislative covenant but prior to its repeal. *Id.* at 179-80, 338 A.2d at 864-65. This evidence is not persuasive absent information on the relative prices at which the series was issued. Moreover, as the court did mention, the series issued shortly after the repeal of the covenant was indirectly protected by the fact that, should the repeal be deemed an unconstitutional impairment, the Port Authority would be obliged to refrain from exceeding the permitted deficit for passenger railroads until the year 2007. *Id.* at 180, 338 A.2d at 865.

171. City of El Paso v. Simmons, 379 U.S. 497, 515 (1965).

172. *See id.* at 514-15.

173. The state's concern at the time the bonds were issued was to obtain financing for

metropolitan area's need for mass transit had increased unexpectedly due to the energy crisis and new pollution standards, there was no showing that the bondholders' protective covenant posed an insuperable barrier to construction of new mass transit. The restrictive covenant did allow the Port Authority to invest in self-supporting passenger railroads[174] and in addition provided that the Authority could incur an unlimited deficit for mass transit if New York and New Jersey would guarantee payment of part of that deficit.[175] Granting that the state's interest in construction of new mass transit facilities was great, it did not appear in the evidence that the state was unable (or had even considered whether it was unable) to construct needed passenger railroads without repeal of the clause.

Thus, while additional security which was written into the bondholders' contract did remain unaltered,[176] repeal of the legislative covenant was not a "mild," "hardly burdensome" measure as in *El Paso*.[177] It was, rather, a total negation of a promise unaccompanied by a showing that the state was unduly burdened by that promise. The repeal was not designed to restore a balance of rights, but rather to lift responsibility from the shoulders of the Port Authority while burdening the bondholders with greater risk.[178] From the facts disclosed in

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the failing Manhattan & Hudson Railroad and for construction of the World Trade Center. 134 N.J. Super. at 159-61, 338 A.2d at 853. Repeal of the covenant was specifically triggered by New York and New Jersey's desire to cooperate on building passenger rail routes from Manhattan to the Newark and Kennedy airports. *Id.* at 171, 338 A.2d at 860.

174. 1962 N.J. Laws ch. 8, § 6; *see* 134 N.J. Super. at 162, 338 A.2d at 854.

175. 1962 N.J. Laws ch. 8, § 6; *see* 134 N.J. Super. at 163, 338 A.2d at 855.

176. The bonds were still secured by a pledge of the Authority's net revenues and reserves. The surplus revenues derived by the Port Authority from all facilities built with the proceeds of sale of its bonds were to be pooled so as to create a general reserve fund in an amount equal to 10% of the par value of all bonds issued by the Authority. 134 N.J. Super. at 141, 338 A.2d at 842. In addition, the Consolidated Bond Resolution, adopted on October 9, 1952 by the Authority, prohibited the issuance of new consolidated bonds unless the best one-year net revenues of all Port Authority facilities were greater than or equal to 1.3 times the prospective debt service for the calendar year during which the debt service of all outstanding and proposed new bonds secured by a pledge of general revenues would be at a maximum. *Id.* at 144, 338 A.2d at 843. The Authority was also required to certify at such time as it issued any bonds secured by a pledge of the general reserve fund with respect to any facility as to which the Authority had not previously issued bonds that, during the next ten years or during the longest term of the proposed bonds, the estimated expenditures in connection with the additional facility would not impair the credit of the Authority, or its ability to fulfill its commitments, or the investment status of its consolidated bonds. *Id.* at 147, 338 A.2d at 845.

177. City of El Paso v. Simmons, 379 U.S. 497, 516 (1965).

178. The New Jersey court emphasized that the remaining security guarantees in the bondholders' contract adequately protected them. 134 N.J. Super. at 196, 338 A.2d at 874. See note 176 *supra*. However, the court did concede that there had been "some

the court's opinion, it does not seem that the enactment was either "mild" in its treatment of bondholders' obligations or "quite clearly necessary" to the public welfare, as required by the *El Paso* standards. Since the police power of the state was not moderately exercised, therefore, the covenant's repeal must have violated the contract clause.

## III. CREDITOR RELATIONS IN FINANCIAL EMERGENCY SITUATIONS

The considerations which determine whether state legislation during the period of a financial emergency violates the contract clause closely resemble those discussed in the context of the state police power. Under emergency circumstances, however, the constitutional impairment formula undergoes some shift in emphasis.

In many contract clause cases, technical impairments of obligations have been excused on the ground that they result from a state's exercise of its "emergency power."[179] The *Blaisdell* Court noted that "[e]mergency does not create power . . . [rather] emergency may furnish the occasion for the exercise of power."[180] It is consistent with *Blaisdell* to describe emergency power as a specialized facet of state police power.[181] Subsequent Supreme Court cases have interpreted *Blaisdell* to mean that the state's police power extends not only to protection of public health, safety and morals, "but also to those extraordinary conditions in which a public disaster calls for temporary relief,"[182] including economic conditions which create an "urgent public need."[183]

The courts have made state legislatures the primary arbiters of the kinds of circumstances in which "emergency may furnish the occasion

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impairment of bondholder security," *id.* at 195, 338 A.2d at 873. In fact, the repeal of the covenant deprived bondholders of any assurances with respect to the amount of deficit at which passenger railroad facilities would be expected to operate. *See id.* at 153-54, 338 A.2d at 849. The importance of the covenant was magnified by the fact that the Port Authority had no general taxing powers. *Id.*

179. *See, e.g.*, East New York Savings Bank v. Hahn, 326 U.S. 230 (1945); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934). *But see* W.B. Worthen Co. v. Thomas, 292 U.S. 426 (1934), wherein the Court declined to justify a state enactment which impaired contract rights on the basis of the state's emergency powers.

180. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 425-26 (1934). In *Blaisdell* emergency power was described as a state power appropriate to extraordinary conditions which may be deemed to be as much a part of all contracts as is the reservation of police power. *Id.* at 439.

181. *See* 36 MICH. L. REV. 1379, 1382 (1938).

182. W.B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934).

183. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 440 (1934); *cf.* W.B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934).

for the exercise of power."[184] Strong judicial deference is given to a legislative declaration of the existence of an emergency situation, such a determination being considered to lie uniquely within the realm of legislative expertise.[185] The cases indicate, however, that if a declaration of emergency could be "regarded as a subterfuge or as lacking in adequate basis"[186] a court would refuse to recognize the existence of an emergency situation. The courts do examine the underlying bases for such a legislative declaration by a review of the legislative history[187] or by taking judicial notice of facts supporting the legislative conclusion.[188]

Having determined that the need to deal with an emergency situation is the permissible goal of particular state legislation, the courts will then examine whether the statute which technically impairs contract rights is "of a character appropriate" to that goal.[189] The courts require that the legislative action "must be limited by reasonable conditions appropriate to the emergency."[190] Whether an appropriate nexus between a legislative enactment and an emergency situation exists often depends on whether the temporal scope of the legislation is coextensive with the temporal scope of the emergency.[191] In *Blaisdell* the Court based its determination of the challenged statute's validity on several criteria, one of which was that the legislation was temporary and hence "limited to the exigency which called it forth."[192] The

184. 290 U.S. at 426.

185. East New York Savings Bank v. Hahn, 326 U.S. 230, 234 (1945) ("Merely to enumerate the elements that have to be considered shows that the place for determining their weight and their significance is the legislature not the judiciary").

Such judicial deference has at times been severely criticized: "[The courts] could not allow the legislative declaration of emergency to be conclusive without severely restricting the power of judicial review." 51 HARV. L. REV. 1292 (1938). The courts do *not* consider such a declaration conclusive, however. See text accompanying notes 186-88 *infra*.

186. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 444 (1934).

187. *See, e.g.*, East New York Savings Bank v. Hahn, 326 U.S. 230, 233-34 (1945).

188. *See, e.g.*, Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 444 (1934).

189. *Id.* at 445; W.B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934).

190. 292 U.S. at 433. In *Thomas*, the Court declared void a state statute which provided that moneys payable to a state resident as the insured or beneficiary under an insurance policy would be exempt from liability or garnishment under judicial process and exempt from application to payment of any debt. *Id.* at 429. The Court found that this exemption from liability was not appropriate to the emergency sought to be contained since it was not limited in amount, it did not include restrictions as to whether beneficiaries must be state residents, and it did not include restrictions particularized according to relevant circumstances. *Id.* at 431.

191. In *Thomas*, the Court also criticized the statute on the basis that it was not limited as to time. *Id.* at 434.

192. 290 U.S. at 447.

Court stated that emergency legislation "could not validly outlast the emergency. . . ."[193]

After *Blaisdell*, much discussion appeared in the literature[194] and in state court decisions[195] as to whether the Supreme Court would be willing to strike emergency legislation similar to that upheld in *Blaisdell* on the ground that the emergency had passed. In *East New York Savings Bank v. Hahn*[196] the Court refused to do so, allowing the state to justify an extension of such mortgage moratorium legislation by invoking state interests other than those which supported the original emergency enactment.[197] On numerous occasions the Court also has upheld legislation which it considered to be of an emergency nature even when no emergency was declared,[198] and perhaps when one did not actually exist.[199] These cases indicate that the reasonable relationship standard is to be applied to a state's purported exercise of the emergency power in much the same manner as it is applied to the state's exercise of its general police power. If anything, the Court would likely be more strict in its scrutiny of the temporal characteristics of emergency legislation.[200]

Although a state legislating in an emergency situation may be more restricted with respect to the reasonable relationship standard, it will surely be easier to show that it acted with moderation. The *Blaisdell* Court set a boundary on the extent to which contract rights may

193. *Id.*

194. *See, e.g.*, 51 HARV. L. REV. 1292, 1293 (1938).

195. *See generally* Mutual Bldg. & Loan Ass'n v. Moore, 232 Ala. 488, 169 So. 1 (1936); National Bank of Aitkin v. Showell, 195 Minn. 273, 262 N.W. 689 (1935); Wilson Banking Co. Liquidating Corp. v. Colvard, 172 Miss. 804, 161 So. 123 (1935) (all upholding mortgage moratoria with the intimation that the legislation would be invalid once the emergency ended).

196. 326 U.S. 230 (1945).

197. *Id.* at 235. The Court found a reasonable relationship between the emergency mortgage moratorium legislation which had been extended and the state's interest in preventing a new emergency which was expected to occur if normal mortgage liquidation, prohibited for eight years, had suddenly been allowed to resume.

The Court has also upheld permanent legislation found to impair the value of contracts but enacted as a means of repairing "weaknesses in the financial system" which had been brought to light by the Depression. Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 39 (1940).

198. In Gelfert v. National City Bank, 313 U.S. 221 (1941), the Court sustained legislation similar to that which had been upheld in Honeyman v. Jacobs, 306 U.S. 539 (1939), as an exercise of emergency power, even though an emergency was not declared by the legislature at the time the statute in *Gelfert* was passed. 313 U.S. at 235.

199. In Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 40 (1940), the Court was not clear as to whether it considered that an actual emergency existed. *See also* East New York Savings Bank v. Hahn, 326 U.S. 230, 235 (1945) (the Court allowed the legislature to avoid a potential "emergency").

200. See notes 190-93 *supra* and accompanying text.

be altered even in an emergency situation when it stated that emergency legislation calling a moratorium on enforcement of creditors' rights could not validly "be so extended as virtually to destroy the contracts."[201] It seems likely, however, that if the statute is deemed a legitimate exercise of the police power, the state's interest in the legislation will be greater when the threat to the public welfare has reached "emergency" proportions. Under the *El Paso* scheme for measuring legislative moderation,[202] an emergency condition will no doubt make any statute which is reasonably related to amelioration of the emergency seem "quite clearly necessary."[203]

Two related cases decided in the wake of New York City's 1975 financial crisis illustrate that the circumstances of an actual financial emergency may make it less likely that any impairment at all will result from a state's alteration of contracts. In *Flushing National Bank v. Municipal Assistance Corp.*[204] and *Ropico, Inc. v. City of New York*,[205] holders of New York City short-term revenue anticipation notes brought suit to challenge the validity of the New York State Emergency Moratorium Act.[206] The Emergency Moratorium Act imposes a three-year moratorium on enforcement of outstanding short-term obligations of New York City, with interest to be paid at the stated rate until the notes mature and at an interest rate of six percent thereafter until the principal is repaid.[207] The Act gave noteholders the alternative of exchanging their short-term obligations for longer-term[208] debt obligations of the Municipal Assistance Corporation of New York City.[209] The federal district court and the Appellate Division of the New York Supreme Court which heard the two cases both upheld the constitutionality of the Emergency Moratorium Act, viewing the legis-

201. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 447 (1934).

202. See notes 140-48 *supra* and accompanying text.

203. City of El Paso v. Simmons, 379 U.S. 497, 516 (1965).

204. 52 App. Div. 2d 84, 382 N.Y.S.2d 764, *rev'd*, 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

205. Civil Nos. 75-6168 and 75-6246 (S.D.N.Y. Sept. 1976).

206. 1975 N.Y. Laws chs. 874, 875; *see* 52 App. Div. 2d at 86, 382 N.Y.S.2d at 765-66; Civil Nos. 6168, 6246, slip op. at 3.

207. 52 App. Div. 2d at 85-86, 382 N.Y.S.2d at 766.

208. The MAC obligations were to have a maturity date of no more than twenty years after issuance and could be "a bond, note or other evidence of indebtedness . . . ." 52 App. Div. 2d at 86 n.1, 382 N.Y.S.2d at 766 n.1.

209. 52 App. Div. 2d at 86, 382 N.Y.S.2d at 766; Civil Nos. 6168, 6246, slip op. at 3. *See* 1975 N.Y. Laws ch. 874, creating the Municipal Assistance Corp. for the City of New York and empowering it to issue and sell its own bonds and notes and to render financial assistance to the City by purchasing City obligations or making direct payments to the City to defray its expenses. *Id.* §§ 3035, 3037.

lation as a proper exercise of the police power.[210] The New York Court of Appeals has subsequently reversed the decision in *Flushing National Bank* on other grounds.[211]

An argument can be made, however, that the statute could also have been vindicated on the ground that it caused no actual impairment of noteholders' rights. When obligations are secured only by the general taxing power of a municipal corporation, the potential for enforcement of such obligations wears thin as the city approaches a financial crisis.[212] The notes were "merely a draft on the good faith of a municipality in exercising its taxing power,"[213] and the value of the noteholders' rights could be only as great as the value of a judgment against the City, assuming that default was imminent.[214] Since the Emergency Moratorium Act authorized six percent interest on the notes during the period of the moratorium, while the interest rate allowed on accrued claims or judgments against the City was three percent,[215] the rights of noteholders under the Moratorium Act were worth at least as much as an outstanding judgment against the City. Given these assumptions, the practical value of the noteholders' contract rights was not reduced

210. 52 App. Div. 2d at 88, 382 N.Y.S.2d at 767; Civil Nos. 6168, 6246, slip op. at 15-16.

211. Flushing Nat'l Bank v. Municipal Assistance Corp., 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976). The reversal was based on a provision of the New York State Constitution which prohibits a city from contracting for indebtedness unless it pledges its "faith and credit" for the payment of the principal of the indebtedness. N.Y. CONST. art. VIII, § 2. Presumably the federal case challenging the Moratorium Act is now moot and will be dismissed unless the New York state courts delay in enforcing the city noteholders' rights or a judicial modification of the noteholders' remedy is imposed.

212. Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 509 (1942). See notes 61-64 *supra* and accompanying text.

It was argued in *Flushing Nat'l Bank* that New York City had reached the point at which its citizens "simply cannot or will not accept increasingly confiscatory tax burdens or the growing danger and deprivation resulting from continued cuts in essential services." Brief for Defendant-Respondent, Flushing Nat'l Bank v. Municipal Assistance Corp., 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976) (brief submitted Aug. 6, 1976).

213. Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 509 (1942).

214. Proof that a city would default rather than pay accruing debt obligations would not be an easy task. It is complicated by the fact that the burden of proof is on the plaintiff to show an impairment of his contract rights. A determination that persons are or are not able to meet their obligations as they come due is obviously within the competence of the courts but its difficulty is greatly magnified when the "person" is a government entity with power to tax. This difficulty may well serve to explain why *Flushing Nat'l Bank* and *Ropico* were decided on the basis of the police power doctrine rather than on technical impairment grounds. See text accompanying note 210 *supra*.

215. General Municipal Laws of New York City § 3-a. *See* Flushing Nat'l Bank v. Municipal Assistance Corp., 52 App. Div. 2d 84, 90, 382 N.Y.S.2d 764, 768 (1976).

by the Emergency Moratorium Act and therefore no impairment was effected by that statute. If at some time during the statutory moratorium, however, the City were to be in a position to comply with the original contract by paying the principal of the notes,[216] noteholders might then successfully claim a technical impairment.[217]

## IV. BANKRUPTCY AND BEYOND

The final question, of course, is what steps can be taken by the state to compose or discharge a prostrate municipality's financial obligations and to settle creditors' claims fairly when all else has failed. Put simply, can a state, by legislation, allow a city to avoid its debts totally?

On the subject of state bankruptcy legislation, much depends on whether federal law has preempted the area.[218] The municipal bankruptcy chapter of the Federal Bankruptcy Act[219] severely limits the types of conditions which may be imposed on a city's creditors by state law—the Act expressly prohibits any state law which imposes a composition on non-consenting municipal creditors.[220]

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216. See note 214 *supra*.

217. One emergency measure a city might employ during a financial crisis is a reduction in the number or remuneration of municipal employees. In order for the contract clause to apply, however, an employee must be working under an explicit contract. Thus, a public officer may have his tenure or salary altered at any time since the state has exclusive power to control the occupancy and emoluments of public offices. *See* Butler v. Pennsylvania, 51 U.S. (10 How.) 402 (1851); *cf.* West River Bridge v. Dix, 47 U.S. (6 How.) 507 (1848). *But see* Robertson v. Miller, 276 U.S. 174 (1928) (a state is liable for services already rendered). Whether a contractual agreement exists between a state and its employees is determined according to state law. *Compare* Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95 (1938) (state statute providing for an indefinite tenure for teachers who had served for at least five years did create a contract), *with* Phelps v. Board of Educ., 300 U.S. 319 (1937) (statute prohibiting board of education from reducing salaries of teachers without cause after three years' service did not create a contract).

If a contract does exist, the contract clause fully protects an employee's rights. The contract is subject, however, to a legitimate exercise of state police power. Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95, 108-09 (1938); *see* Subway-Surface Supervisors Ass'n v. New York City Transit Auth., 85 Misc. 2d 695, 381 N.Y.S.2d 186 (Sup. Ct. 1976) (holding that a wage freeze imposed on Transit Authority employees was reasonably related and properly directed to alleviation of the New York financial emergency).

218. The United States Constitution gives Congress the power "to establish . . . uniform Laws on the subject of Bankrnptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4. This clause does not deny states the power to enact bankruptcy or insolvency laws, Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 191-97 (1819), but when the subject matter of state laws in this area is in conflict with federal law, state law is deemed superseded. *Id.* at 196; *see* Straton v. New, 283 U.S. 318, 327 (1931); Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 262-63 (1827).

219. 11 U.S.C.A. §§ 401 *et seq.* (Supp. 1976).

220. Nothing contained in this chapter shall be construed to limit or impair

Assuming that the state's action has not been preempted by federal law, the contract clause does not prohibit a state from imposing an extension or a composition. As might be expected, the contract clause was not always given such a liberal interpretation. In one of the earliest contract clause cases, *Sturges v. Crowninshield*,[221] the Supreme Court struck down state bankruptcy legislation as applied to pre-existing contracts.[222] After development of the police power doctrine, however, the Court came to view state bankruptcy legislation with more tolerance. In *Faitoute Iron & Steel Co. v. City of Asbury Park*[223] the Court upheld a statute allowing municipal creditors to force the city into something resembling an equity receivership with a composition to be imposed on all creditors after approval by eighty-five percent of them.[224] While recognizing that "a state insolvency act is limited by the Contract Clause of the Constitution in authorizing composition of pre-existing debts," the Court determined that whether such an act is unconstitutional "depends upon what is affected by such a composition and what state power it brings into play."[225] The Court thus employed a contract clause analysis no different from that applied to any other challenged state law. Since the present Federal Bankruptcy Act does not preclude states from imposing extension plans on municipal creditors,[226] state legislatures should be able to impose extensions on pre-existing municipal creditors so long as the action results in no technical impairment or may be justified as a proper exercise of the police power.[227]

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the power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its political or governmental powers, including expenditures therefor: *Provided, however,* That no State law prescribing a method of composition of indebtedness of such agencies shall be binding upon any creditor who does not consent to such composition, and no judgment shall be entered under such State law which would bind a creditor to such composition without his consent. *Id.* § 403(i).

221. 17 U.S. (4 Wheat.) 122 (1819).

222. *Id.* at 205-06.

223. 316 U.S. 502 (1942).

224. *Id.* at 504. Court approval of the plan was also required, and several criteria of fairness which the court was to examine were set forth in the statute. The plan could not include a reduction of principal and was to be binding on all creditors regardless of whether they made an appearance. *Id.* See notes 51-57 *supra* and accompanying text.

225. 316 U.S. at 513.

226. *See* Ropico, Inc. v. City of New York, Civil Nos. 6168, 6246 (S.D.N.Y. Sept. 1976), slip op. at 25-29. Compositions, by contrast, are precluded. See note 220 *supra* and accompanying text.

227. *See* Ropico, Inc. v. City of New York, Civil Nos. 6168, 6246 (S.D.N.Y. Sept. 1976), slip op. at 12-16, where the federal district court for the Southern District of New York used a standard contract clause/police power analysis in upholding the New York State Emergency Moratorium Act for the City of New York. See notes 204-10 *supra* and accompanying text.

When a municipal corporation is in hopeless financial straits, revoking the municipal charter might appear to be the final opportunity to free the city from its creditors. States have plenary power, unaffected by the contract clause, to revoke the charter of a municipal corporation and to withdraw its powers entirely.[228] State power over municipal corporations, then, is more extensive than state power over business corporations.[229] Nevertheless, all existing contracts of the municipal corporation remain in full force when a municipal charter is revoked.[230] In addition, when a state has authorized a municipality to tax for the purpose of meeting its obligations, that taxing power may not be withdrawn except as a proper exercise of state police power if city creditors have contracted for the payment of their claims by means of that resource.[231]

A municipality's liabilities may be enforced in a number of ways following revocation of the municipal charter.[232] In several cases,[233] a city's charter has been repealed and a new municipal government established in its place. The Supreme Court has held that the successor city becomes liable for the debts of its predecessor if both cities encompass substantially the same area, contain substantially the same taxable property, and are organized for the same general purposes.[234]

228. Hunter v. City of Pittsburgh, 207 U.S. 161, 178-79 (1907) (voters and taxpayers have no contract right to continuation of municipal corporation even though forced consolidation of their town with a larger municipality would lessen the efficacy of their vote); Meriwether v. Garrett, 102 U.S. 472, 511 (1880); 2 E. McQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 9.24, at 692 (3d ed. 1966); Schulz, *The Effect of the Contract Clause and the Fourteenth Amendment Upon the Power of the States to Control Municipal Corporations*, 36 MICH. L. REV. 385, 400, 405 (1938).

229. *Cf.* Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

230. Graham v. Folsom, 200 U.S. 248, 253 (1906); Mobile v. Watson, 116 U.S. 289, 305 (1886); Broughton v. Pensacola, 93 U.S. 266, 270 (1876); Schulz, *supra* note 227, at 400.

231. Graham v. Folsom, 200 U.S. 248, 250 (1906); Mobile v. Watson, 116 U.S. 289, 305 (1886); Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 554-55 (1866); Schulz, *supra* note 227, at 406; *cf.* Meriwether v. Garrett, 102 U.S. 472, 520 (1880).

232. Courts can reach only the non-public property of an extinct municipal corporation to satisfy existing debts. Werlein v. New Orleans, 177 U.S. 390 (1900). From the municipal creditor's point of view, this remedy is distinctly unsatisfactory. Most city property is deemed to be impressed with a public trust and therefore exempt from levy for satisfaction of city debts. *See* Note, *Creditors' Remedies in Municipal Default*, 1976 DUKE L.J. 1363, 1369-70.

233. *See, e.g.*, Mobile v. Watson, 116 U.S. 289 (1886); Broughton v. Pensacola, 93 U.S. 266 (1876). In *Watson* the state repealed the charter of the City of Mobile and subsequently incorporated the Port of Mobile, comprised of substantially the same taxable property and population but including only about half the area of the former city. In *Broughton* the city's charter was surrendered and the citizens established a new corporate municipal government encompassing substantially the same area, but with different powers and officers.

234. Mobile v. Watson, 116 U.S. 289, 300 (1886). *See generally* Schulz, *supra* note

When the state abolishes a municipal corporation and does not create a direct successor but instead divides the geographic area of the town among several existing municipal corporations, these newly enlarged municipalities become liable for their respective shares of the extinct corporation's unpaid obligations.[235] If, however, territory is detached from one municipal corporation by annexation to another, the old corporation remains liable for debts incurred before separation[236] unless the legislature establishes an equitable plan for apportioning liability between the two.[237] The state cannot prevent a city's debts from following it even by abolishing the municipality and subsuming it into a county unit governed by state officers who are statutorily forbidden to assess or collect taxes for payment of the defunct city's bonds.[238]

If a municipal corporation is abolished and no political subdivision is given authority over the area, those who hold the obligations of the now-extinct municipality apparently have no recourse except to apply to the state legislature for relief.[239] Nevertheless, unless the state is willing to leave a former municipal corporation with no organized local government, it appears that the contract clause does not permit a state to free its cities from debt by abolishing the municipal corporate structure. Of course, some alteration of the carry-over of city obligations might be reconciled with the police power doctrine.[240]

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227, at 404. A successor municipal corporation is liable for the debts of its predecessor even if the predecessor was dissolved because it had been unlawfully organized and even if the reincorporation act provides that the new municipality will be liable for the debts of the predecessor only if the voters decide to assume them. Shapleigh v. San Angelo, 167 U.S. 646 (1897).

235. Mount Pleasant v. Beckwith, 100 U.S. 514 (1879); *see* B. WRIGHT, *supra* note 3, at 229.

236. Laramie County v. Albany County, 92 U.S. 307 (1875).

237. Morgan v. City of Beloit, 74 U.S. (7 Wall.) 613 (1868); *see* Schulz, *supra* note 227, at 404.

238. Graham v. Folsom, 200 U.S. 248 (1906).

239. *See* Meriwether v. Garrett, 102 U.S. 472, 501 (1880) (general taxes levied before repeal of city charter cannot be collected through court of chancery; Court expresses no opinion on whether different result would obtain in case of taxes levied in obedience to contract obligations); Barkley v. Board of Levee Comm'rs, 93 U.S. 258 (1876) (after municipal corporation abolished without successor, court would not issue mandamus to compel assessment and collection of taxes under repealed tax law requiring a tax for payment of liabilities for construction of levees; petitioner was owed money for work and labor done on levees); B. WRIGHT, *supra* note 3, at 229; Schulz, *supra* note 227, at 405.

240. The cases discussing the consequences of repeal of a corporate charter are from an era before the police power doctrine was fully developed in the contract clause area. Hence a police power analysis must be engrafted onto their rationale to bring them up to date.

## CONCLUSION

It is clear that states can now reach a constitutionally acceptable avoidance of municipalities' literal debt obligations in a number of situations. Not every legislative alteration of contractual terms or of the statutory measures necessary to enforce those obligations will be considered an impairment. Only such legislation as actually diminishes the practical value of the original contract will be labeled an impairment within the meaning of the contract clause. Moreover, even though a contract may be technically impaired by state legislation, the contract clause does not void the statute if (1) the legislation bears a reasonable relationship to ends which are within the realm of protection under the state's police power, and (2) the legislation reflects a spirit of moderation which at least preserves the quality of the affected party's contract as an acceptable investment and strikes a balance between the state's purposes and the affected party's interest so that the alteration of contract appears reasonably necessary to the state's goals.

This construction of the contract clause is certainly open to criticism. Recently the financial community has applauded the decision of the New York Court of Appeals which invalidated on state constitutional grounds the moratorium on payment of New York City notes.[241] The lower courts had held that the moratorium was valid under the contract clause, however, and the Court of Appeals did not discuss or disturb that ruling.[242] The decision triggered the issuance of indebtedness by smaller cities in New York state which had been unable to float bonds since New York City's 1975 crisis.[243]

Criticism of a contract clause interpretation which places a premium on state flexibility with respect to the alteration of an obligor's contract rights is not new.[244] As early as 1788, James Madison insisted that

> laws impairing the obligation of contracts are contrary to the first principles of the social compact, and to every principle of sound legislation. . . . The sober people of America . . . have seen, too, that one legislative interference is but the first link of a long chain of repetitions, every subsequent interference being naturally produced by the effects of the

241. *See* Wall St. J., Nov. 23, 1976, at 38, col. 1.

242. Flushing Nat'l Bank v. Municipal Assistance Corp., 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

243. N.Y. Times, Nov. 24, 1976, at 1, col. 5.

244. Warnings of the danger of allowing states the leeway to interfere with contractual relationships are found in the dissents of Justice Black in City of El Paso v. Simmons, 379 U.S. 497, 517 (1965), and Justice Sutherland in Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 448 (1934).

> preceding. They very rightly infer, therefore, that some thorough reform is wanting, which will banish speculations on public measures, inspire a general prudence and industry, and give a regular course to the business of society.[245]

One may doubt whether the protection rendered by the contract clause today satisfies this concern with the value of an individual's contract rights and the ensuing dangers for commercial activity should such rights be ignored.

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245. THE FEDERALIST No. 44, at 128-29 (G.P. Putnam's Sons ed. 1889) (J. Madison).