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Toward a Revitalization of the Contract Clause

Richard A. Epstein†

The protection of economic liberties under the United States Constitution has been one of the most debated issues in our constitutional history.¹ Today the general view is that constitutional protection is afforded to economic liberties only in the few cases of government action so egregious and outrageous as to transgress the narrow prohibitions of substantive due process.² The current attitude took its definitive shape in the great constitutional battles over the New Deal, culminating in several important cases that sustained major legislative interference with contractual and property rights.³ The occasional Supreme Court decision hints at renewed judicial enforcement of limitations on the legislative regula-

† James Parker Hall Professor of Law, University of Chicago. This paper was originally prepared for a conference on "Economic Liberties and the Constitution," organized at the University of San Diego Law School in December, 1983, under the direction of Professors Larry Alexander and Bernard Siegan. I also presented it as a workshop paper at Boston University Law School in February, 1984. I wish to thank all the participants for their valuable comments and criticisms. I also wish to thank David Currie, Geoffrey Miller, Geoffrey Stone, and Cass Sunstein for their helpful comments on an earlier draft of this article.

¹ The classic work on the subject is C. BEARD, *AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES* (1913).

² The leading recent case is *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 14-38 (1976). I have criticized the decision in Epstein, *Taxation, Regulation and Confiscation*, 20 *OSGOODE HALL L.J.* 433, 442-43 (1982).

³ See, e.g., *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937); *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937).

tion of economic activities,⁴ but these traces fade as quickly and quietly as they appear.⁵ The egregious and outrageous legislative enactments seem always to lie just over the horizon, to be struck down on a tomorrow that rarely comes. Interest groups are told that they have the wealth and power to defend themselves in the legislative arena, and that scarce judicial resources must be devoted to the protection of "discrete and insular" minorities unable to fend for themselves.⁶ The dominant distinction today is between "preferred freedoms" or "fundamental rights" on the one hand, and all subordinate rights on the other. Economic liberties and property rights are clearly placed in the subordinate class. Doctrinally, the point of departure may be the eminent domain clause, the due process clause, the equal protection clause, the uniformity clause, or, as here, the contract clause. But no matter where the journey begins, functionally it always ends at the same place: judicial passivity and legislative dominance.⁷

The received wisdom is so entrenched, I believe, because of a powerful alliance between two groups with very different political and legal orientations. On the one side lie the New Deal liberals, who favor legislative intervention in the marketplace on its merits; in consequence they are loathe to invoke judicial activism to strike down such legislation on constitutional grounds. On the other side lie the conservatives, whose abiding affection for majority will and judicial restraint leaves them undisposed to strike down legislation that they often regard as substantively unsound. These two schools of thought often differ sharply on the merits of modern disputes over equal protection, searches and seizures, or freedom of speech. But as a string of unanimous Supreme Court opinions suggests, there is almost universal agreement on the desirability of judicial passivity in economic matters.⁸ Sustained and principled opposi-

⁴ See, e.g., *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 240-51 (1978), discussed *infra* notes 50-56 and accompanying text.

⁵ See, e.g., *Exxon Corp. v. Eagerton*, 103 S. Ct. 2296, 2304-07 (1983), discussed *infra* notes 94-99 and accompanying text.

⁶ See, e.g., *United States v. Carolene Prods. Corp.*, 304 U.S. 144, 152 & n.4 (1938).

⁷ For an alternative account of the common threads that run through these separate doctrinal areas, see Sunstein, *Naked Preferences and the Constitution*, 84 COLUM. L. REV. (1984) (forthcoming).

⁸ One recent illustration is *United States v. Ptasynski*, 103 S. Ct. 2239, 2245-46 (1983), where the Court upheld, by unanimous vote, the windfall profits tax on oil against a challenge under the uniformity clause, though the tax provided a special exemption for oil produced in most areas of northern Alaska. For a discussion of the uniformity clause and a criticism of *Ptasynski*, see Comment, *The Uniformity Clause*, 51 U. CHI. L. REV. (1984) (forthcoming).

tion to this coalition comes only from those who both (a) find fatal substantive flaws in the interventionist legislation, and (b) deny that any principle of judicial restraint has a proper constitutional pedigree, in economic matters or anything else.⁹

This article concentrates on only one of the constitutional provisions that bears on the general topic of economic liberties: the contract clause, which reads: "No State shall . . . pass any . . . Law impairing the Obligation of Contracts"¹⁰ I wish to defend the proposition that, properly construed, the clause extends substantial protection to economic liberties against legislative, and perhaps judicial, interference. My task in the first part of the article is to explain how and why the Constitution itself commits us to a theory of governance that, to understate the point, leaves to state governments only a very limited control over the economic activities within their jurisdictions. Those who think that the "realities" of modern political life preclude the adoption of such a system of governance may find my argument an idle one. But I think that a reexamination of the first premises of our constitutional system is always in order, and that such an examination can be conducted without any presumption for or against the current status quo. The formulation of a program of implementation can be properly undertaken only after the question of principle has been addressed. Turning to specific applications of the contract clause in Part II, I hope also to show that the internal logic of the clause, like the theory of governance that inspired it, points to a sharp restriction of the power of the individual states to regulate economic affairs.

I. INTERPRETING THE CONTRACTS CLAUSE

A. The Intent of the Framers

The first question to face in this inquiry is a familiar one: how to interpret a document that was drafted in a style broad in outline and short on detail. One method is to start with a detailed

* For a sympathetic discussion of economic substantive due process, see B. SIEGAN, *ECONOMIC LIBERTIES AND THE CONSTITUTION* 3-59 (1980). For a more skeptical analysis of substantive due process, see Easterbrook, *Substance and Due Process*, 1982 SUP. CT. REV. 85, 85-119, 125.

¹⁰ U.S. CONST. art. I, § 10, cl. 1. The full clause reads:

No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

historical inquiry into the social context in which the Constitution was adopted. It is possible to point to a number of pressing contemporary issues that led to the inclusion of the contract clause in the Constitution. There had been efforts to interfere with the stability of state currencies, and to repudiate various pre-Revolutionary-War debts, especially those owed to British subjects. Many states had created extensive networks of public monopolies, franchises, and privileges, as well as wide arrays of local restrictions on trade and commerce. One possible interpretation of the contract clause is that it was designed solely to prevent the repudiation of foreign debts without interfering with the traditional modes of economic regulation undertaken by the states. Yet, as ever, there are a number of obstacles to making any definite link between contemporaneous political and economic disputes and the contract clause. The clause is drafted with a generality that appears to transcend the particulars of any immediate dispute—a sensible approach to drafting a document meant to provide a stable, long-term framework for governance.¹¹ In addition, the plain language of the clause imposes limits on the powers of the states, suggesting as much an attack on traditional local practices as an endorsement. The inference, therefore, from general history to text is as vexed in connection with the contract clause as it is elsewhere, and it is noteworthy that the major decisions interpreting the contract clause do not rely upon the particulars of that history. Nor should that be surprising. No one would argue that the fourth amendment reaches only the writs of assistance, even though it was their flagrant abuse by royal officials that spurred its adoption; nor would anyone say that the first amendment guarantee of freedom of speech prohibits only federal seizure of local newspapers or direct censorship prior to publication.

If a study of the social and political context of the clause reveals little about the intentions of the framers, not much more is to be gleaned from the historical accounts of the debates at the drafting and ratifying conventions. The framers themselves wanted their deliberations to be kept confidential, and for good reason. The publication of the discussions and debate may add further data, but it does not necessarily add further insight. On the contrary, the debates only distract us from the text and from the inferences to be drawn from a careful textual examination. Nevertheless, constitutional scholars often do focus on the debates at the

¹¹ See *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 406-07 (1819) (Marshall, C.J.).

drafting and ratifying conventions. Since this history has been carefully studied by others, a quick summary will serve here. It does not yield much fruit.¹²

As drafted, the clause is in the nature of a general declaration. As befits a constitution, all of the key terms—"impairing," "Obligation," or "Contracts"—remain undefined. The debates over the clause were brief and inconclusive, and did not address the range of its possible application. There is very little reason to think that the framers had any theory about the contract clause, or pondered its implications for cases to which it would be applied. They might have been astonished at the scope of a clause, the logical implications of whose language they must have appreciated dimly at best. Yet this is not to say that the framers would have rejected the implications once they were laid bare, for they could well have believed that the ability to make principled extensions of the constitutional doctrine was but a hidden sign of the strength of their original work. Although chosen as representatives of their various states, they came to the convention with a powerful conviction that trade and commerce were a social good, best fostered by institutions that restrained the use of force and stood behind private commercial arrangements. The want of any extended debate about the contracts clause may be attributed as easily to a basic consensus on its role as to its supposed unimportance.

There is of course no guarantee that this brief sketch captures the mood of the framers better than its rival,¹³ which treats the clause as a provision of minor importance. Given such irreducible uncertainty, it seems best not to look for the intent of the framers in the individual thoughts of the various delegates or any consensus that they may have reached. More reliable is to treat the Constitution as a whole as the best evidence of that intention, and to try to make sense of what the framers did, not of their motives for doing it. The real questions are about the reasonable implications of the contract clause, given its language and the context in which it appears.

I propose to consider here six separate issues related to the proper interpretation and scope of the contract clause. All of these

¹² See B. WRIGHT, *THE CONTRACT CLAUSE OF THE CONSTITUTION* 3-26 (1938), which contains the early historical information upon which I rely. For a thorough discussion of the case law, see Hale, *The Supreme Court and the Contract Clause* (pts. 1-3), 57 *HARV. L. REV.* 512, 621, 852 (1944).

¹³ See B. WRIGHT, *supra* note 12, at 243; Note, *A Process-Oriented Approach to the Contract Clause*, 89 *YALE L.J.* 1623, 1626-27 (1980).

issues have arisen in the long and complex history of the clause, and in their proper resolution lies the key to its understanding. The six issues are:

(1) Does the clause apply only to contracts between private parties, or does it include contracts to which the state is a party?

(2) Does it apply only to debtor-creditor relationships, or to all private contracts, regardless of subject matter?

(3) Does the clause only proscribe laws that permit obligors to escape from their obligations, or does it protect all rights and duties on both sides of the contractual relationship?

(4) Does it protect only contracts that are already formed from retroactive intervention, or does it apply to contracts that may be made after the passage of some general law?

(5) Is the clause subject to any implicit exceptions, and if so, how are they defined and limited?

(6) Does it guard against judicial as well as legislative impairments of the obligation of contracts?

The role of the clause is largely determined by the way these questions are answered. At one extreme, the clause could be limited to prohibiting legislation directed to the blanket discharge of existing debts. At the other extreme, the clause could insulate contractual relations against any and all forms of state regulation, whether by legislature or court, including even so modest an intervention as a statute of limitations. Such an interpretation represents a more absolute protection of contracts than even the most ardent advocates of contractual freedom think desirable.

I have already indicated my reasons for thinking that the detailed history of the drafting and ratifying conventions is of little use in resolving the specific interpretive questions that have subsequently arisen. On these six matters, moreover, that history is surprisingly uninformative. First, there was no real debate about whether the clause governed contracts with the state, or was limited to private engagements only, and the commentary on the subject that emerged in the decade after the Constitution was adopted is inconclusive.¹⁴ Second, many of the other prohibitions of article

¹⁴ See B. WRIGHT, *supra* note 12, at 15-18, 21-25. What evidence of original intent there is suggests that the clause should be limited to private contracts. Nevertheless, the argument that the clause extended to contracts with the state had been made even before the Court so held in *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 135-39 (1810), notably by Hamilton

I, section 10¹⁵—e.g., those against coining money, emitting bills of credit, and making anything but gold and silver coin legal tender in payment of debts—show a special concern with the debtor-creditor relationship. But the language of the contract clause, like that of the ex post facto clause, is far broader, suggesting that it was designed to reach matters falling outside the scope of these narrower provisions.

Third, it is not clear what kinds of impairments the clause on its face prohibits. On the one hand, the word "obligation" may be read as referring to a contractual burden; if so, the state may impose new burdens on contracting parties, but may not eliminate those already in place. On the other hand, "obligation," as it is found in the phrase "the law of obligations" and in standard Roman and Civil law usage,¹⁶ refers to the entire relationship and not to just one side of it, suggesting that any alteration in the private relationship is governed by the clause.¹⁷ Matters are made somewhat more obscure because the committee on style originally used the phrase "altering or impairing the obligation of contracts" then later deleted the first two words.¹⁸ This change could have been substantive, lending strength to the narrower reading of the clause, or simply stylistic, leaving all interferences with contractual relationships within the scope of the clause.

Fourth, and perhaps most critically, the original intent as to the applicability of the clause to prospective impairments is unclear. There was some suggestion at the constitutional convention that only retroactive interferences were condemned, but the point is hardly conclusive.¹⁹ Article I, section 10 also contains a prohibition against ex post facto laws, which on its face might apply to both civil and criminal cases; it was only *Calder v. Bull*²⁰ in 1798

in the 1790's. See B. WRIGHT, *supra* note 12, at 21-22.

¹⁵ See *supra* note 10 (quoting U.S. CONST. art. I, § 10, cl. 1).

¹⁶ The framers may have been influenced, at least indirectly, by Roman and Civil law usage. See B. WRIGHT, *supra* note 12, at 10-12 & n.22.

¹⁷ "In all cases, an *obligatio* had two sides: the right and the duty," W. BUCKLAND, A TEXT-BOOK OF ROMAN LAW FROM AUGUSTUS TO JUSTINIAN 406 (P. Stein 3d rev. ed. 1963). The standard Roman definition of *obligatio* is "a legal bond, with which we are bound by a necessity of performing some act according to the laws of our State." THE INSTITUTES OF JUSTINIAN, bk. 3, tit. 13, at 130 (J. Moyle trans. 5th ed. 1913). Note that the definition itself speaks both of the bond and the act to be performed. The phrase "*alicuius solvendae rei*" (performing some act) "must be understood as covering any render or service with a money value." W. BUCKLAND, *supra*, at 406.

¹⁸ See B. WRIGHT, *supra* note 12, at 9.

¹⁹ See *id.* at 8-9.

²⁰ 3 U.S. (3 Dall.) 386, 390-91 (Chase, J.), 395-96 (Paterson, J.), 399-400 (Iredell, J.) (1798).

that limited the clause to criminal cases. Had the *ex post facto* clause actually been understood by the founders to reach civil actions, then the contract clause, if confined to retroactive impairments, would be redundant.²¹ The reverse argument, however, cannot be made, for if the *ex post facto* clause reaches only criminal sanctions, article I, section 10 as a whole remains internally consistent, since the contract clause could still cover both past and future impairments.

Finally, the question of exceptions to the absolute language of the clause is similarly vexed. The concern was voiced at the convention that literal construction of the contract clause could prevent so useful a form of government regulation as the limitation of actions by statute.²² But even if these statutes escape invalidation under the contract clause, we do not know what exceptions must be read into the clause or how deeply they cut. An exception that saves the statute of limitations need not save the bulk of state laws that have been held immune to challenges under the contract clause.

B. The Structure of the Constitution

In order to overcome these historical weaknesses and interpretive gaps, it seems not only proper, but necessary, to look beyond the debates over the particular clause, to more general and widely shared conceptions of government and contract, on the theory that they influenced the basic constitutional structure. Perhaps the clearest and most important purpose of the Constitution was to place a set of limitations upon government power, both at the state and at the federal levels. The primary end of the framework for government envisioned by the framers was to avoid the twin perils of dictatorship on the one hand and tyranny by majorities on the other. The extreme forms of popular democracy were rejected as sharply as was the divine right of kings, a fact indicated by the elaborate safeguards on voting that abound in the Constitution. In addition, by the end of the eighteenth century there was a well-established body of jurisprudence about the nature of contractual obligation and the proper limitations on the principle of freedom

²¹ For the arguments supporting application of the *ex post facto* clause to civil cases, see W. CROSSKEY, *POLITICS AND THE CONSTITUTION IN THE HISTORY OF THE UNITED STATES* 324-51 (1953). Crosskey overstates the certainty of his conclusion, but his evidence raises powerful doubts about the proposition that the *ex post facto* clause was originally meant to apply only to criminal matters.

²² See B. WRIGHT, *supra* note 12, at 8.

of contract within the private sphere. Finally, as the text of the Constitution itself suggests, "the eighteenth-century draftsman felt no obligation to spell out every last detail in the documents he drew"; instead, he was careful in his use of general terms, and left the rest "to the rules of interpretation customarily followed by the courts."²³ This view of the framers' drafting strategy invites the exceptions and qualifications to the general prohibition set out by the clause itself.

A focus on the eighteenth-century background puts us at one remove from the document itself, but it has the compensating advantage of allowing us to look to a body of insights and shared understandings, many of which are on the public record. It becomes possible therefore to ask about the implications of a general theory, and to avoid the inconclusive investigation into the private understandings of a group of individuals who subscribed to that theory.

Our first line of inquiry is to ask what drove the framers to embrace the principle of limited government. That government had to exist was taken as a given, for, as men schooled in Hobbes and Locke, the framers understood that government was the only effective way to constrain the private use of force and hence to ensure civil order. But the great danger of government is that it will itself become the enemy: *Quis custodiet custodies?* Whatever the juristic status attributable to government, in the end the decisions it makes are made by individuals. The decisionmaking processes of government fall easy prey to control by groups—the "factions" of Madison's *The Federalist* No. 10²⁴—who can use the mantle of government power to deprive persons of their liberty and property. Property here should be broadly understood. Madison said elsewhere that it embraced "every thing to which a man may attach a value and have a right; and *which leaves to everyone else*

²³ W. CROSSKEY, *supra* note 21, at 364. Crosskey's view was that the contract clause operated as a total ban on state legislation that impaired present or future contracts, but was to have no effect upon legislation already in place in 1789. Crosskey believed that the total withdrawal of power from the states was consistent with a scheme granting Congress full power to deal with all contractual matters under the commerce clause. Crosskey's understanding of eighteenth-century canons of draftsmanship is oddly inconsistent with his interpretation of the contract clause because the latter's absolute nature would preclude the possibility of any police power or just compensation exception to the basic prohibition. Crosskey does not explicitly address the possibility of these exceptions. See W. CROSSKEY, *supra* note 21, at 352-60 (a section confidently entitled "The True Meaning of the Contracts Clause: Herein of the Extent to Which the National Commerce Power was Made 'Sole and Exclusive'").

²⁴ THE FEDERALIST No. 10, at 78 (J. Madison) (C. Rossiter ed. 1961).

the like advantage"—a conception that includes a man's property in both "the free use of his faculties and [the] free choice of the objects on which to employ them."²⁵

The dangerous implications of this observation for government were exemplified by much of the state legislation passed about the time of the Constitutional Convention.²⁶ Self-interest and abuse of power are themes that resonate in all social life. One cannot assume that the virtuous will obtain public office, or that, if they do, they will retain their virtue in the face of pressure and temptation.²⁷ The great danger is that, once in office, legislators need no longer rely upon naked aggression to exact private gain, but can instead enlist the force of the state by passing laws that work to advance their own interests at the expense of the public or some part of it. Legislators, in other words, cannot be given the power of absolute owners because they hold power as trustees for the benefit of the public. The old maxim, "A public office is a public trust," is not simply metaphor. Those entrusted with public power act as fiduciaries and must avoid conflicts of interest every bit as much as private trustees who hold the reins of power for private beneficiaries.

The distinction between owners and trustees, public and private, runs through the entire fabric of our law. In ordinary private transactions, each person, unencumbered by trust, sells what he owns in order to obtain what he desires. No person is allowed to deal in property that he or his opposite contracting party does not own: *Nemo dat quod non habet*. Deals struck in the private arena may advance the mutual interests of the parties to them, but they are unexceptionable from a social point of view so long as they do not trench upon the rights of third parties. Legislators, by contrast, are trustees, and as such they have the power to deal with property and opportunities that are not their own. Indeed it is the essence of legislation to take private property, to merge it into a common pool, and then to distribute it in ways determined by collective political decisionmaking. The lurking danger is that legisla-

²⁵ Madison, *Property*, The Nat'l Gazette, Mar. 29, 1792 (emphasis in original), reprinted in 6 THE WRITINGS OF JAMES MADISON 101 (G. Hunt ed. 1906).

²⁶ See B. WRIGHT, *supra* note 12, at 4-5, for a discussion of the framers' dissatisfaction with these laws. The theme was also echoed in the context of interstate commerce in *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 440 (1827) (Marshall, C.J.) ("Conceding, to the full extent which is required, that every State would, in its legislation on this subject [commerce], provide judiciously for its own interests, it cannot be conceded, that each would respect the interests of others.").

²⁷ See THE FEDERALIST No. 51, at 321-22 (J. Madison) (C. Rossiter ed. 1961).

tors will ignore the terms of their trust, coalesce into factions, and dispose of the beneficial interests of others for their own personal gain.

This central problem of governance is very old, but in recent years it has been captured in the language of economics: any grant of legislative power will invite "rent-seeking" behavior; each group will try to use that legislative power to expropriate the wealth of its rivals. Economic rents are measured by the difference in value to the owner derived from the best use of a given asset and the value derived from its next best use.²⁸ Where that gap is large there is a target for expropriation by legislative activity, as a well-aimed tax or regulation can reduce the return to the private owner without inducing him to shift to his next best activity. If such a tax or regulation is implemented, it should, it seems, affect only wealth distribution but not resource allocation. To give a concrete example, suppose that the best use of a given asset yields its owner \$100 while its next best use yields but \$50. A tax of \$25 on the preferred use will not induce the owner to redeploy his asset and will net the beneficiaries of the tax or regulation \$25. By contrast, a tax of \$60 will net the legislature nothing, as the owner prefers the \$50 derivable from the second best activity to the \$40 left to him from the first. It is tempting to conclude that taxes or regulations directed solely at economic rents (i.e. any tax or regulation costing less than \$50 in the above example) will have no allocative consequences. But that conclusion is false because it ignores the strong likelihood that the legislative efforts to tax or regulate will be resisted by the private parties they hurt. These private parties will be prepared to spend real resources in order to defeat pending taxes or regulation whose import they could not successfully evade upon passage. The proponents of the legislation likewise are prepared to devote resources to the passage of the desired regulation. The economic rents associated with any given resource uses are in large part dissipated by this rent-seeking behavior so typical of partisan strug-

²⁸ "The quasi-rent value of the asset is the excess of its value over its salvage value, that is, its value in its next best use to another renter." Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 298 (1978). The existence of rents in ordinary commercial transactions leads to efforts by one side or the other to "appropriate" that rent to itself, often by breaching a contract. The private-law question of how business transactions should be organized to prevent that appropriation has its public-law analogue in the question of how social affairs should be organized to prevent that appropriation through public-law processes. See J. BUCHANAN & G. TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 43-62 (1962).

gle.²⁹ While deals in the world of trade will in general be positive sum games, the self-dealing of parties in public power can easily become negative sum games.

The recent growth of the interest-group theory of legislation provides powerful evidence of the persistence and extent of legislative abuse.³⁰ More to the point, the theory is consistent with what the framers themselves believed to be the evils inherent in the legislative process. *The Federalist* No. 10 on the evils of faction offers as forcible a condemnation of interest-group legislation as one might hope to find.³¹ *The Federalist* No. 44 pursues the same theme by stressing that one purpose of the Constitution was to prevent the endless legislative battles aimed at the redistribution of opportunities and wealth between factions.³² For concrete, everyday examples of what the framers feared, one need only look at the way in which factions behave before the New York City Rent Board when public meetings are used as a forum in which to deter-

²⁹ For a collection of essays on rent-seeking, see *TOWARD A THEORY OF THE RENT-SEEKING SOCIETY* (J. Buchanan, R. Tollison & G. Tullock eds. 1980).

³⁰ For general treatments of the theme, see Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). Even though the self-interest theory does not explain all legislation, its importance points to the need to place constitutional controls upon the legislative process.

³¹ *THE FEDERALIST* No. 10, at 79-84 (J. Madison) (C. Rossiter ed. 1961).

³² The sober people of America are weary of the fluctuating policy which has directed the public councils. They have seen with regret and indignation that sudden changes and legislative interferences, in cases affecting personal rights, become jobs in the hands of enterprising and influential speculators, and snares to the more industrious and less informed part of the community. They 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 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.

THE FEDERALIST No. 44, at 282-83 (J. Madison) (C. Rossiter ed. 1961). But cf. Thayer, *The Origin and Scope of the American Doctrine of Constitutional Law*, 7 HARV. L. REV. 129, 153-56 (1893) (arguing that the checking of legislative power by excessively detailed constitutional prohibitions imposed by the judiciary will make government "petty and incompetent").

Incidentally, it is in large measure the constitutional structure envisioned by the framers that also makes it very difficult to dismantle large government programs once they are in place. This fact, however, does not so much reflect shortcomings of the framers' scheme as its abandonment by subsequent legislatures. The scale on which these large programs now exist would flabbergast *all* of the framers, regardless of the differences among them. Those differences, after all, went less to the need for limited government than to the question of what the limitations should be. Thayer argues that to check legislative power with excessively strict constitutional prohibitions imposed by the judiciary will make government "petty and incompetent." But by removing entirely certain issues from the legislative agenda, such limitations might well improve the level of debate.

mine rents under the City's rent control statute, or the way in which any zoning board bargains with individual developers. What difference can it make that the framers knew nothing of rent control, zoning, or quasi-rents?

Such modern examples of the potential for legislative abuse only lend force to the view, evident in both the framers' general theory and the text they drafted, that government power must be curbed. The framers were concerned that legislative deals would often be tainted by interest-group politics, and occasionally by outright bribery, and that preoccupation with redistributive matters would divert individuals from productive activities. They sought to control those abuses by adopting a scheme of limited government. If this sketch captures something of the general mood of the time, then it seems quite impossible to infer that the framers intended judicial deference to the legislature on all economic matters.

The task of limited government, then, is to forge those institutions that will control the abuses of trust without depriving government of the powers needed to maintain the social order. Given the persistence of rent-seeking and self-interest, the only way to prevent *all* excesses is to eliminate all government. Since that course entails unacceptable risks of its own, the question must be phrased more delicately: what techniques can maximize the gains from government over the costs imposed by the universal tendency to self-interest in public affairs?

To their credit, the framers did not rely upon a single method to forestall legislative abuses. One technique was to create a system of checks and balances whose major function was to place procedural obstacles in the path of legislation. At the federal level, the two houses of Congress, the staggered terms of senators, the short terms of representatives, the veto power in the President, and the supermajorities required to override the presidential veto are all parts of a system presupposing that, generally, the error costs from too much legislation exceed the error costs from too little. No system can eliminate the problem of factions, but the procedural hurdles to the enactment of federal legislation are so structured that a faction resisting legislation will not lose upon a single defeat, but will have the opportunity to fight again in a somewhat different setting where the rules may be more to its advantage. Conversely, the procedural requirements raise the cost for a faction seeking new legislation, thereby reducing the effectiveness of small coalitions and limiting the scope of governmental activity. These procedural requirements are further reinforced in the Constitution by limiting the exercise of congressional power to enumerated areas.

The central government thus was given few powers and was compelled to negotiate complex paths to exercise those it had. The biases in the system were all designed to keep the government small, and not to expand its scope.

These procedural and jurisdictional requirements, of course, do not bind the states (although many states have copied them in their own constitutions); indeed, it is quite inconceivable that any federal constitution could have been ratified had it sought to set the terms and conditions under which state legislatures operated. The control of abuse in state government had to take a different tack. Since state legislative processes were beyond federal control, the Constitution had to place substantive limitations upon state legislative power. This technique works best when it is possible to identify areas where there is a shared presumption that government intervention is mischievous. Once an area is selected, the substantive prohibition then limits the range of deals that can be struck. By indirect means the Constitution shrinks the gains obtainable by factions, and thereby tends to reduce the incentives for their formation, though at the cost of some good legislation foregone. Article 1, section 10 is replete with substantive limitations upon the jurisdiction of state legislatures. The *ex post facto* clause is one illustration that looks only to past actions, while the total prohibitions against granting titles of nobility, entering into treaties, alliances, or confederations, or coining money, have an obviously prospective application. Similarly, the framers' shared belief in the importance of trade and commerce shows that limitations upon the state's power to interfere with contractual arrangements are consistent with the basic constitutional scheme, even if the categorical nature of the prohibition cannot be maintained.³³

I believe that this argument, derived from the Constitution and the general theory underlying it, satisfies the requirements for principled judicial intervention formulated by the advocates of judicial restraint. Robert Bork, for example, in his examination of neutral principles, directs his heaviest fire at decisions that have invalidated state legislation under the due process or equal protection clauses.³⁴ Bork recognizes, however, that the Constitution provides "specified rights" under particular substantive provisions, as well as "secondary or derived individual rights," which "are lo-

³³ See *infra* notes 74-115 and accompanying text (discussing police power and just compensation limitations on these prohibitions).

³⁴ See Bork, *Neutral Principles and Some First Amendment Problems*, 47 *IND. L.J.* 1, 17 (1971).

cated in the individual for the sake of a governmental process that the Constitution outlines and that the Court should preserve.”³⁵ These conditions are stated in the alternative, but with the contract clause they are satisfied simultaneously. The contract clause is an explicit limitation upon the power of the state to trench upon individual rights; rent-seeking by factions is a persistent feature of our institutional life that in turn justifies the broad construction of the basic provision. Although the economic desirability of private contracts may at first glance appear far removed from the concerns of governance, the protection of private contracts against government regulation is inseparably entwined with two elements of a distinctively political cast: individual freedom, of which freedom of contract is but one illustration, and the need to prevent legislative misbehavior, itself a central concern of any constitutional arrangement.

II. SPECIFIC APPLICATIONS

There remains the question of how to apply the contract clause to concrete situations. Today, the general view is that the clause cannot be given a “literal” reading because any absolute injunction against the impairment of any and all contracts would deprive the states of the essential attribute of sovereignty—the power to pass legislation that is in the public interest. The inference typically drawn from this observation is that the contract clause itself must be read as but another version of substantive due process.³⁶ This argument, however, is not made with regard to all facially absolute provisions of the Constitution. The first amendment freedom of speech clause, for example, is not given a “literal” reading, *pace* Justices Black and Douglas, yet the clause nevertheless is broadly interpreted, reaching even areas, such as state common law actions for defamation, where the framers might have thought it did not apply. So too with the contract clause. There is an enormous middle ground between an absolute interpretation of the contract clause and the near total disregard that it receives today. The language of John Marshall in *Trustees of Dartmouth College v. Woodward*³⁷ furnishes a far better guide to interpretation than the pallid evasions in vogue today:

It is not enough to say, that this particular case was not in the

³⁵ *Id.*

³⁶ See, e.g., L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 9-6, at 469 (1978).

³⁷ 17 U.S. (4 Wheat.) 518 (1819).

mind of the Convention, when the article was framed, nor of the American people, when it was adopted. It is necessary to go farther, and to say that, had this particular case been suggested, the language would have been so varied, as to exclude it, or it would have been made a special exception. The case being within the words of the rule, must be within its operation likewise, unless there be something in the literal construction so obviously absurd, or mischievous, or repugnant to the general spirit of the instrument, as to justify those who expound the constitution in making it an exception.³⁸

The task of constitutional construction has advanced little since Marshall left it. It remains to find an intermediate account of the clause that preserves its basic structure from evisceration without barring all legislation on contractual matters. In more functional terms, the task is to find a construction that does not inhibit legitimate legislative activities (i.e. those that provide genuine public goods), but does check the major rent-seeking effects of faction in the legislative process. Such an effort to restrict legislative power, like other social endeavors, is always subject to two forms of error: legislative initiatives that should succeed may be blocked, yet, at the same time, legislation that should be blocked may in fact be enacted.

The first speaks to the need for government; the second to the need for limitations upon government power. As it is quite impossible to devise a set of perfect rules, the task is to develop those rules that minimize the sum of error in the two directions, taking into account the frailties of both legislatures and courts. The proper way to proceed is best determined by looking again at the six doubtful points of constitutional construction to which the text as written supplies no authoritative answer.

A. State Contracts

The contract clause should apply both to contracts between private parties and to contracts to which the state is a party. Although the word "impairment" tends to suggest a prohibition upon the interference with private contracts, the language of the document makes no express distinction between the two classes of ar-

³⁸ *Id.* at 644-45. Note that Marshall used similar techniques of construction to show that the broad language of the commerce clause was a proper response to a particular perceived mischief. See *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 445-47 (1827) (invalidating a Maryland statute imposing a licensing requirement on importers of foreign goods).

rangements. In addition, the problem of legislative abuse is as great in the one context as in the other. I begin with the assumption that a state may contract with individual citizens to fulfill its public functions unless there is some constitutional provision—e.g. against the sale of titles of nobility—that limits the state's general power. Of course, a state may obtain a voluntary release from its contractual obligations, just as can a private party. To allow a state to repudiate its contracts unilaterally, however, is to invite the very abuses of factional coalition that the contract clause was designed to prevent, for we can be sure that almost every repudiation will provide benefits to some groups at the expense of others. To insist upon the indefeasible status of state contracts would reduce the potential gains to be derived from the factional coalition, and thereby act as an indirect check on legislative abuse. It seems clear, however, that the contract clause does not make public contracts indefeasible, for there is no reason why a state cannot condemn property that it has already conveyed pursuant to contract.³⁹ Upon condemnation, of course, the state would be required to pay just compensation, but even this requirement only reduces the potential gains from rent-seeking factionalism to the difference between the value of the property to the state (or, more accurately, to the groups benefitted by the state's action), and its value in the hands of its original private owners. The important question with respect to public contracts is whether the challenged governmental action results from the political intrigue that a sound system of limited government is designed to forestall.

Two important cases indicate that public contracts, as much as private ones, are subject to the abuses that the contract clause was meant to curb. In the *Dartmouth College* case,⁴⁰ the state sought to dilute the College's Board of Trustees and to obtain control over the college seal—actions that doubtless were to the advantage of some political groups and not others.⁴¹ The case might have presented major difficulties had the state decided to pay compensation for breaching its charter, because it is hard to identify the appropriate parties to compensate: direct payment to the Board would accomplish little if the composition of the Board itself were changed to reflect the newly dominant political groups. But matters were made easy because once the state refused to compensate anyone, the trustees were properly entitled to specific

³⁹ For further discussion of this point, see *infra* text following note 106.

⁴⁰ *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

⁴¹ See B. WRIGHT, *supra* note 12, at 40-41.

relief against all the state's actions. The trustees were in the position of a private owner who can resist condemnation when state payments are not forthcoming.

A similar situation arose more recently in *United States Trust Co. v. New Jersey*.⁴² The Port Authority of New York and New Jersey had sold some bonds to private investors. The bonds contained covenants expressly prohibiting the use of the sale proceeds for mass transit. Twelve years after the bonds were issued, both New Jersey and New York enacted retroactive statutes allowing the proceeds to be used for mass transit notwithstanding the covenants in the original bonds. No alternative security measures were offered to the original bondholders⁴³ and there was evidence, if evidence was needed, that the value of the bonds declined in response to the abrogation of the covenants.⁴⁴ No private borrower could simply have ignored the covenants without triggering an immediate default on the bonds. The question, therefore, was whether New York and New Jersey could insulate themselves from default by passing legislation authorizing the abrogation of the covenants. The Court rightly held that in this "financial" matter the state was free to make a binding contract limiting its own power, since the state had other available means to subsidize the growth of mass transit without placing a special burden on the bondholders.⁴⁵ While the public stands to gain from subsidizing mass transit, the general taxing power of the state is always available to raise money for such programs. It may well be, of course, that the legislature will balk at the costs of the fresh appropriation, but that is itself a useful institutional check upon government spending—a check that would be utterly undone if money previously lent to the state for one purpose could be diverted at will by government agencies. There is no reason to allow the state to trick a group of individuals

⁴² 431 U.S. 1 (1977).

⁴³ *Id.* at 19.

⁴⁴ *Id.* at 18-19.

⁴⁵ *Id.* at 24-32. The opinion itself, however, is far too muddy in leaving open the possibility that contracts could be impaired if the impairment were "reasonable and necessary" to accomplish some important public purpose. *Id.* at 25. What is needed is a *specification* of the relevant ends and the appropriate means, lest the whole structure of the contracts clause disintegrate into a formless set of exceptions. The proper approach in such cases is for the state to condemn the covenant if it wishes, paying just compensation for what it takes. For an endorsement of this approach, see *id.* at 19 & n.16, 29 n.27; Kraft, Loikith & Petkanics, *Accommodating the Rights of Bondholders and State Public Purposes: Beyond United States Trust*, 55 TUL. L. REV. 735, 766-71 (1981). For a discussion of the just compensation limitation on the contract clause, see *infra* notes 100-15 and accompanying text.

into parting with money on one set of conditions only to find that it is bound by another.

The decision in *United States Trust* is welcome because it preserves the long-term soundness of government lending markets from the short-term opportunistic behavior of a few of its participants. *United States Trust* was only difficult because other recent Supreme Court decisions, notably that in *Usery v. Turner Elkhorn Mining Co.*,⁴⁶ showed substantial tolerance for retroactive laws in other contexts. But as a matter of first principle, there is nothing to be gained by leaving the question of a contract's enforceability to legislative decision when the sole effect of doing so is to provoke bitter battles between bondholders and their rivals over the use of the bond money. The opportunities for rent-seeking in this context are legion, because if the legislature can get its way, then moneys that were once uniquely appropriated by contract can be returned to the common pool to be reallocated through the political process. The net effect is to oust definite property rights by means of political calling cards, with devastating effects upon the political and financial soundness of both public and private institutions. Even if the text of the contract clause is ambiguous on the question of whether the prohibition it states extends to public contracts, the theory behind the text calls for such an extension.⁴⁷

B. Private Contracts

The second question admits of an even clearer answer. Creditor-debtor relationships, one leading concern of the framers in drafting the clause,⁴⁸ offer a wide array of possibilities for legislative misappropriation, but the danger of the abuse is not limited to that class of contracts alone. It is present in any area with appropriable rents. The contract clause is written broadly enough to avoid any conflict between its language and a proper interpretation of its scope.

⁴⁶ 428 U.S. 1 (1976) (upholding the Black Lung Benefits Act of 1972, Pub. L. No. 92-303, 86 Stat. 150 (codified as amended at 30 U.S.C. §§ 901-51 (1982))).

⁴⁷ It is perhaps ironic that the contract clause today has greater force with respect to state contracts than with respect to private ones. For a discussion of the current application of the clause to contracts by government parties, see L. TRIBE, *supra* note 36, § 9-7. Tribe asserts: "When government makes that choice [i.e. to signal its trustworthiness], a powerful argument may be advanced that the most basic purposes of the impairment clause, as well as notions of fairness that transcend the clause itself, point to a simple constitutional principle: *government must keep its word*." *Id.* at 470 (footnote omitted) (emphasis in original). Tribe's statement of the principle is far too broad, for it precludes even the possibility of impairing a contract upon payment of just compensation.

⁴⁸ See B. WRIGHT, *supra* note 12, at 4-6.

C. The Construction of "Obligation"

A construction of the term "obligation" to include rights as well as duties is also indicated. The contract clause requires that the legislature be precluded from releasing a promisor from his obligations because of the need to guard against the evils of legislative appropriation. Yet the dangers of legislative abuse are not limited to misconduct with respect to promisors; promisees, motivated by self-interest, may seek from the legislature the imposition of additional obligations on promisors. A functional interpretation of the clause, one that focuses upon the control of factional abuse, therefore, treats the "obligation" as embracing the entire relationship, not just the obligor's side of it. This understanding of the term was expressed by Justice Washington in *Green v. Biddle*.⁴⁹

Any deviation from [a contract's] terms, by postponing or accelerating the period of performance which it prescribes, imposing conditions not expressed in the contract, or dispensing with the performance of those which are, however minute, or apparently immaterial, in their effect upon the contract of the parties, impairs its obligation.

The recent case of *Allied Structural Steel v. Spannaus*⁵⁰ highlights the wisdom of this position. Allied had decided to close up its operations in Minnesota and to move elsewhere. After Allied created a pension plan, but before it decided to relocate, the Minnesota legislature enacted a statute requiring the company to fund pension rights that had not become vested under the terms of the original agreement, thereby "dispensing" with conditions found in the private contract between employer and employee.⁵¹ The legislative maneuvering to defeat the mobility of capital across state lines is evident enough from the apparent statutory purpose.⁵² The Court rightly held that the contract clause prevented the legislature from retroactively modifying the terms on which the company had agreed to compensate its employees and from imposing new monetary obligations upon Allied.⁵³

⁴⁹ 21 U.S. (8 Wheat.) 1, 84 (1823).

⁵⁰ 438 U.S. 234 (1978).

⁵¹ See *id.* at 247-48 (quoting the district court, which had upheld the law).

⁵² See *id.* The Minnesota statute is the Private Pension Benefits Protection Act, MINN. STAT. ANN. §§ 181B.01-181B.17 (West Supp. 1984).

⁵³ 438 U.S. at 244-51.

Justice Brennan, in dissent, hewed to the narrow line that the contract clause prohibits only the relaxation of contractual burdens, not their imposition.⁵⁴ He also argued that the legislation was "designed to remedy a serious social problem arising from the operation of private pension plans."⁵⁵ Yet his dissent does not explain why this "social problem" is one that calls for state intervention.⁵⁶ Indeed a proper analysis points quite the other way. One of the enduring advantages of a federal system is that it permits competition among jurisdictions for businesses. Each state legislature is therefore constrained in its ability to impose burdens upon commerce by the threat that businesses will go elsewhere. This private restraint on legislative exactions is far from ideal because exit is a right that is costly to exercise, but such inefficiency is hardly reason to reduce its effectiveness even further by countenancing additional state exactions upon private parties who decide to exercise that option. Nor is there any reason to suppose that the right of a business to relocate is purchased at the expense of the general welfare, given the benefits that a firm's movement will bring to individuals in other states. The Minnesota statute struck down in *Spannaus* exemplifies the unfortunate local protectionism that the Constitution was designed in part to overcome. Obligations should embrace the entire contractual relationship, not one side of it alone.

D. Retroactive and Prospective Application

The fourth question of interpretation is whether the contract clause has prospective as well as retrospective application. This question is by far the most controversial and important of the six. If the clause limits only retroactive modifications of contractual obligations, it still has an important role to play in a constitutional scheme, although one that is far more restricted than if it is read to limit prospective modifications as well.

Once again, despite the importance of the question, the language of the clause does not answer it. The phrase "Obligation of Contracts," read to emphasize the plural, could suggest that only past contracts, individually negotiated, are covered by the clause.

⁵⁴ *Id.* at 251 (Brennan, J., dissenting).

⁵⁵ *Id.* at 252 (Brennan, J., dissenting).

⁵⁶ Justice Brennan suggests that pension plans are often "grossly unfair" and that they can deprive employees of benefits "reasonably" anticipated. *Id.* But these conclusions are indefensible given that the clarity of the contract determines the legitimacy of the expectation.

Yet that inference is by no means compelling, since the plural might have been included only to ensure that all types of contracts come within the ambit of the clause. In the absence of an express reference to existing contracts, there is no textual contradiction in reading the clause to provide that a state may not impair the obligation of contracts, present or future. The language of the Ordinance for the Northwest Territory, drafted only several years before, adds force to this reading:

And in the just preservation of rights and property, it is understood and declared, that no law ought ever to be made or have force in the said territory, that shall in any manner whatever interfere with or affect private contracts or engagements, bona fide, and without fraud previously formed.⁵⁷

Since this clause was an obvious model for the contract clause,⁵⁸ the omission of anything like its last two words from the constitutional provision suggests that the latter was meant to have broader scope. In short, both interpreting the clause to forbid and interpreting it to allow prospective modifications is consistent with the text as written. The question is how to resolve the impasse.

The best way to approach the problem is to stress again the reasons to limit state legislative power. It is easy to establish that the retroactive legislative modification of contractual obligations offers a fertile field for political abuse. If X lends Y \$1000, a law passed after the transaction releasing X from that indebtedness is (ignoring the detriment to Y's reputation) worth \$1000 for Y to obtain, and \$1000 for X to resist. The prospect of retroactive legislation invites both sides to make the appropriate expenditures to achieve their respective ends. The result is a negative sum game, since Y has no incentive to take into account the losses sustained by X, and vice versa; whether or not the legislation is obtained, the costs of the struggle are a deadweight loss. The greater risk, to be sure, arises if Y succeeds and the legislation is enacted, because the result will be unnecessarily to increase the cost of borrowing money. But even thwarted efforts to obtain legislative interference impose great costs. The vice is as much in the struggle as in the outcome. The power of the contract clause is that it forestalls such struggles by rendering the outcome so certain that no one will be prepared to undertake the expense needed to undo vested contractual rights. The system is better off, therefore, if efforts to obtain

⁵⁷ Northwest Territory Ordinance and Act of 1787, art. II, 1 Stat. 51, 52 n.(a) (1789).

⁵⁸ See B. WRIGHT, *supra* note 12, at 6-7.

retroactive legislation are ruled out of bounds by constitutional decision.

It is a mistake, however, to assume that these abuses are confined to retroactive adjustments of contractual obligations. The extreme cases bear out this proposition. If the contract clause does not limit the state's power to regulate the right to make future contracts, then it is perfectly acceptable for the state to pass a law barring any individual from entering into any contract whatsoever, be it for the transfer of property or the rendering of services. Indeed, within the framework of the original constitutional scheme, one could go further and impose those limitations upon certain classes of individuals or certain types of contracts, since any limits imposed by the equal protection clause on state action came into play only after the Civil War. Yet is this a pattern consistent with any theory of limited government?

Once it is admitted that certain prospective limitations on contract are barred by the contract clause, it is no longer possible to erect an iron wall against its prospective application. Since the text itself is silent on the question of its scope, the analysis of other cases must turn on the extent to which the prospective interference with contract offers the opportunities for the dissipation of wealth through political action. Take the case in which group A works to obtain a law curtailing competition in the marketplace from group B. This pattern underlies laws providing, for example, that opticians may not fit eyeglasses without a prescription from ophthalmologists or optometrists,⁵⁹ or that usury laws apply only to nonbanking institutions.⁶⁰ The net effect of such restraints is to shift opportunities, and ultimately wealth, from one group to another. In a system without constitutional constraint, the opportunity for such diversion exists in very large measure even where the legislative interference is prospective only. If, as is generally true of activities subjected to regulation, the potential gains are large, each side will devote substantial resources to advance its position, again in the course of a negative sum game. The contract clause, accordingly, has the same effect when applied to future contracts that it has when applied retroactively: it serves to direct private

⁵⁹ See *Williamson v. Lee Optical Co.*, 348 U.S. 483, 485 & n.1 (1955) (holding that such a statute is not unconstitutional under the fourteenth amendment).

⁶⁰ *Griffiths v. Connecticut*, 218 U.S. 563, 570 (1910) (holding that exemption of banks and trust companies from state usury statute does not violate equal protection clause of the fourteenth amendment).

activities away from the dissipation, and toward the creation, of wealth.

The prospective application of the contract clause has been attacked on the ground that only "settled expectations," which are said to arise only from existing contracts or other "vested rights, should be protected."⁶¹ But the conclusion that the clause should be confined to existing contracts does not follow from the premise. Trade and commerce are networks of transactions that extend over long periods of time. Individuals buy, rent, and hire today in the expectation that they will be able to sell, lease, or use tomorrow. Can it really be argued that settled expectations have been protected if a merchant is required to respect existing contracts of purchase even though the legislature thereafter restricts his prospective power of sale? Or that the settled expectations of a tenant under a long-term lease have been protected when the legislature raises the minimum wage by twenty-five percent, thereby rendering the property useless to the tenant because he cannot hire the labor that he needs to operate it? A theory of settled expectations requires not only the enforcement of existing contracts, but also a respect for the stable institutional framework that makes it possible for persons to make long-term arrangements without being blindsided by laws that disrupt their business operations while enforcing contracts already in place.

To put the point another way, it is often said that prospective legislation is fundamentally different from retroactive legislation because it affords notice, thereby allowing the regulated parties to avoid acting in violation of the law. The difference is plain enough, but it cannot support the black and white distinction that it is used to defend. Giving notice permits individuals to mitigate their private losses, but is unlikely to leave individuals newly subject to regulation as well off as they were in the absence of the regulation. If it did, after all, the regulated parties would have no reason to challenge the legislation in the first place. Opticians are less well off because they cannot replace broken eyeglasses. Parties prohibited from making loans above certain fixed interest rates can avoid statutory penalties by withdrawing from the market, but they still will be unable to recoup their expected profits from a foregone venture. The businessman burdened with a long-term lease made

⁶¹ See L. TRIBE, *supra* note 36, § 9-1, at 456 ("We deal here with the idea that government must respect 'vested rights' in property and contract—that certain settled expectations of a focused and crystallized sort should be secure against governmental disruption, at least without appropriate compensation.").

worthless to his business by legislation may surrender to his landlord or sublease, but only at substantial financial loss.

Nor can the sorry state of affairs just envisioned be justified by the argument that contracts embody not only the private understandings of the parties but also the terms that the state imposes as a condition of allowing business to be done. That argument is so powerful that it subjects all existing contracts to the overriding condition, rendering the contract clause a nullity. To assume, as has been suggested, that all private contracts are entered into subject to a "master term" whereby they incorporate both present and future positive rules is a way to annihilate the clause, not to interpret it. Suppose, for example, the state passed a law which read in full: "Any private contract entered into after the passage of this statute shall be subject to abrogation or modification by subsequent legislation." The statute would be but a transparent attempt to claim for the state power that the Constitution removes from it, and could not withstand serious constitutional scrutiny.

In essence, the appeal to some "master term" subverts the relationship between the Constitution and state legislation. It allows the legislature to expand its powers as long as it acts quickly, and it converts the ideal of contract from a source of private right based upon private volition into yet another object of legislative faction. No private party, *X*, could ever legitimately say to *A* and *B* that they must contract among themselves on terms that meet *X*'s satisfaction if they wish to contract at all. The very demand, if backed by force, would be tortious: it would be a clear interference with prospective advantage, actionable at common law long before the adoption of the Constitution.⁶² It is difficult to argue against the existence of such a tort within the private context, and there is no reason why the limitations that are good against *X* should not prevail against the legislature, whose abuse of power the Constitution was designed to limit.

The propriety of analogizing the legislature to a private party, *X*, derives force from references in the early case-law discussion about the Constitution to the "natural law" basis for the contract clause. To be sure, the framers did not appeal to some abstract principle of natural law as a check on the explicit provisions of the Constitution; the detailed language and structure of the document

⁶² See, e.g., *Carrington v. Taylor*, 11 East 571, 572-73, 103 Eng. Rep. 1126, 1126-27 (Q.B. 1809) (plaintiff entitled to damage for disturbance of his "ancient decoy" by defendant).

preclude the argument that there is some restraint upon government power that is not explicitly connected with the text.⁶³ But there is a second sense in which the Constitution is very much a natural law document. Unlike many modern statutes, the Constitution does not contain a definition section, although there are many terms, including "contract," that cry out for some definition. To say that the Constitution is a "natural law" document is to say that its terms are to be understood in accord with their use in the general legal culture. Because in general legal usage the term "contract" has a fixed and definite meaning, viewing the Constitution as a natural law document prevents the legislature from nullifying private arrangements by its own redefinition of the critical terms of constitutional discourse. "Contract," as a natural law term, designates the agreement in fact between the parties, not merely those portions of it that the legislature is prepared to enforce. Pothier, for example, defines a contract as "[a]n agreement by which two parties reciprocally promise and engage, or one of them singly promises and engages to the other to give some particular thing, or to do or abstain from doing some particular act."⁶⁴ If the legislature announces in advance that it seeks to condition that agreement in some way, the parties can ignore the threat as they go about their business, for any agreement they reach will have contractual status under a natural law definition like Pothier's that treats contracts as consensual in origin. Once the private agreement is reached, its obligation is necessarily impaired by the statute that seeks to deny or limit its validity.

The costs of any other approach to defining the Constitution's vocabulary are impossible to bear. To deny that terms like contract, property, speech, and taxation have fixed and definite meanings that resist arbitrary redefinition is to destroy both constitutional government and the rule of law, for no form of words can then ever limit government power. As a general proposition there is a powerful link between the professed inability of courts to understand ordinary language and their willingness to defer to the

⁶³ The point is made forcefully in J. ELY, *DEMOCRACY AND DISTRUST* 88-101 (1980).

⁶⁴ 1 R. POTHIER, *A TREATISE ON THE LAW OF OBLIGATIONS, OR CONTRACTS* 3-4 (W. Evans trans. Philadelphia 1826). Contrast the usage of the Uniform Commercial Code by which "[c]ontract" means the total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law." U.C.C. § 1-201(11) (1978). That definition works well insofar as it allows supplementation by statute where the parties are silent. Where the terms of the statute purport to oust the terms of the agreement, however, the definition becomes unsuitable for constitutional purposes, no matter what the conventions of the statute.

exercise of arbitrary legislative power.⁶⁵ After all, if no one really knows what contracts are, how can there be any great hardship or injustice in reading the contract clause out of existence? But if these rights are held dear, then the willingness to celebrate the infinite plasticity of language speedily disappears. No one interested in the freedom of speech, for example, argues that a challenged phrase in the first amendment is meaningless even though everyone admits that there are obvious ambiguities in its language. Much less would one allow Congress to redefine the meanings of speech (e.g., to exclude movies) or the press (e.g., to exclude magazines or pamphlets) to evade the first amendment.⁶⁶ The same attitude toward language must be adhered to when construing the contract clause. The clause was drafted against the background of a longstanding and clear definition of contract. The constitutional protections the clause affords should not be frittered away under the guise of linguistic skepticism.

The failure to grasp these principles has led to unfortunate constitutional confusions. Ever since *Ogden v. Saunders*⁶⁷ was decided in 1827, the contract clause has been read not to reach agreements that operate only *in futuro*. Because prospective limitations can be as mischievous as retroactive ones, strong principles of substantive due process were seized upon toward the end of the nineteenth century in order to fill the gap created by *Ogden's* narrow interpretation.⁶⁸ Had the contract clause been construed to apply prospectively, state minimum wage, maximum hour laws and the like could have been scrutinized under that provision without the Court incurring the charge that it had arrogated unto itself control of substantive issues entrusted to the legislature.⁶⁹

The gaps left by the decision in *Ogden v. Saunders* also help explain the rise of the negative, or dormant, commerce clause. As

⁶⁵ I have explored this point at greater length in Epstein, *Not Deference, But Doctrine: The Eminent Domain Clause*, 1982 Sup. Ct. Rev. 351, 355-56.

⁶⁶ See *New York Times Co. v. Sullivan*, 376 U.S. 254, 269 (1964) ("mere labels" do not confer "talismanic immunity from constitutional limitations").

⁶⁷ 25 U.S. (12 Wheat.) 213 (1827). The vote was four to three. Marshall wrote the dissent, his only dissent on constitutional matters.

⁶⁸ Substantive due process was invoked chiefly to protect liberty of contract. See, e.g., *Lochner v. New York*, 198 U.S. 45, 53 (1903).

⁶⁹ While any ultimate determination of constitutionality under the contract clause will depend upon the reach of the exceptions to the clause, to be considered presently, see *infra* notes 74-115 and accompanying text, no one could argue that the subject matter of minimum wage, maximum hour legislation is left wholly within the discretion of the legislature, limited only by other principles, like the equal protection clause, that are not defined in terms of that subject matter.

drafted, the commerce clause seems only to confer power upon Congress and not to impose any limitations upon the state. "Congress shall have Power . . . To regulate Commerce . . . among the several states"⁷⁰ looks like an affirmative grant of power to the federal government and not an implicit limitation upon the states.⁷¹ If the contract clause is given prospective application, then there is far less need to worry about the negative implications of the commerce clause. The necessary restrictions upon state power are found elsewhere in the Constitution. But if the contract clause is confined to the protection of existing contracts, then the structural coherence of the Constitution is weakened, as there are no necessary institutional limitations that work against the petty, provincial, and retaliatory trade practices that spurred the original ratification of the Constitution. It is therefore not surprising that the gap in the constitutional structure created by *Ogden* was filled by the growth of the negative commerce clause, for it is a commonplace that coalition politics at a national level could well preclude federal legislation necessary to overcome protectionist or discriminatory legislation adopted by the states.⁷²

Nonetheless, the shift in focus from the contract clause to the commerce clause comes at a price that is not measured solely by the textual coherence of the position. The invocation of the negative commerce clause helps prevent only the exploitation of out-of-staters by persons inside the state. It does nothing to prevent the exploitation of one local group by another, when participation in legislative activities itself does not prevent local expropriation. To be sure, there are practical differences between the cases, as it is easier for in-state parties to receive some quid pro quo when subjected to disadvantageous legislation. But these issues properly go to the just compensation exception under the contract clause,⁷³ and not to the scope of the contract clause itself.

E. Exceptions to the Contract Clause: Of the Police Power and Just Compensation

The answers to the first four questions all point to an ex-

⁷⁰ U.S. CONST. art. I, § 8, cl. 3.

⁷¹ See Currie, *The Constitution in the Supreme Court: State and Congressional Powers, 1801-1835*, 49 U. CHI. L. REV. 887, 943 (1982).

⁷² See, e.g., *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 614-29 (1981) (sus- taining Montana's sharp increase in severance taxes on coal because it did not discriminate between in-state and out-of-state users). For criticism, see Epstein, *supra* note 2, at 445-49.

⁷³ See *infra* notes 100-15 and accompanying text.

panded contract clause. The limits of its application come into focus, however, when we consider the fifth question: what limits are consistent with the basic structure of the contract clause? Marshall's canon of construction set out in *Trustees of Dartmouth College v. Woodward*⁷⁴ again points to the need for exceptions to the clause. The combination of the four principles thus far stated would brook no legislative interference with the enforcement of any contractual obligation. On the face of the argument as it now stands, the state could not impose a statute of limitations, a statute of frauds, or even a codification of the parol evidence rule. Indeed, the entire Uniform Commercial Code would be subject to constitutional challenge to the extent that it varied from the idealized doctrines of contract contemplated by the clause, not only as it applies to unconscionable contracts, but also with regard to the rules governing firm offers, frustration, or damages in the event of breach. Neither could statutes provide special relief against promises procured by fraud or duress, or regulate contracts whose object is the destruction of property or the infliction of personal injury upon a third person. This conclusion is all the more startling because while the Constitution would take these matters away from state legislatures, it would not subject them to legislative control at the federal level, unless one accepts Crosskey's extreme, and untenable, view that the commerce clause gives Congress sole and exclusive jurisdiction over all contractual matters, even those which might be regarded as intrastate.⁷⁵ There thus would be a huge void in an essential area of law. So "mischievous" a construction of the clause, as Marshall would put it,⁷⁶ makes plain the need for some limitations on the prohibition that the clause sets out.

What form should these limitations take? The traditional view has been that the contract clause must be subject to a police power limitation.⁷⁷ It is also maintained, chiefly in connection with government contracts, that the contract clause is also subject to a just compensation limitation.⁷⁸ While it might appear that the recognition of these two limitations in tandem justifies the modern demolition of the contract clause, that conclusion is easily resisted once

⁷⁴ 17 U.S. (4 Wheat.) 518, 644-45 (1819), *quoted supra* text accompanying note 38.

⁷⁵ *See supra* note 23.

⁷⁶ *Dartmouth College*, 17 U.S. (4 Wheat.) at 644, *quoted supra* text accompanying note 38.

⁷⁷ *See Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 205 (1824) (Marshall, C.J.), *discussed in Currie, supra* note 47, at 945.

⁷⁸ *See, e.g., United States Trust Co. v. New Jersey*, 431 U.S. 1, 19 & n.16 (1977); *supra* note 45.

the scope of each of these two implied exceptions is properly identified.

1. *Police power.* Although a police power limitation is nowhere mentioned in the contract clause, such a limitation is necessary. The limitation, however, should not be construed so broadly as to destroy the impact of the constitutional prohibition, just as an expansive view of, to use the modern phrase, a "compelling" state interest should not serve to repeal the first amendment or the equal protection clauses.

One may begin to define the scope of the police power limitation by recalling that the contract clause was designed to combat the practice of legislative self-dealing, of legislators dealing with property they do not own. Since private parties can engage in similarly abusive transactions—as when two parties make an agreement to violate the rights of a third—the police power limitation on the contract clause may be no more than a means for the state to protect against such private abuse. The police power limitation leaves the state free to prevent the commission of crime or tort, to control the use of force and fraud. This notion is no subtler than the view that freedom of speech under the first amendment does not require the abolition of the private tort of defamation.⁷⁹ As Holmes rightly said, "[o]ne whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them. The contract will carry with it the infirmity of the subject matter."⁸⁰

Does the police power limitation properly extend beyond the protection of third-party interests? In the years before the New Deal, the proper scope of the police power was the dominant concern in cases of economic regulation challenged under theories of substantive due process. *Lochner v. New York*,⁸¹ for example, did not decide that freedom of contract was a protected liberty under the due process clause; the earlier decision of *Allgeyer v. Louisiana*⁸² had explicitly so held. Rather, the particular question in *Lochner* was whether a maximum-hour statute for certain kinds of bakers fell within the police power of the state.⁸³ It bears noting that precisely this inquiry would have arisen in *Lochner* if *Ogden*

⁷⁹ This notion was implicit in *New York Times Co. v. Sullivan*, 376 U.S. 254 (1964) (first amendment limits libel actions against government officials to cases where actual malice can be proved).

⁸⁰ *Hudson County Water Co. v. McCarter*, 209 U.S. 349, 357 (1908).

⁸¹ 198 U.S. 45 (1905).

⁸² 165 U.S. 578; 589 (1897).

⁸³ *Lochner*, 198 U.S. at 53.

v. Saunders had upheld the prospective application of the contract clause. In that instance, *Lochner* would have been an obvious contract clause case, and the question of the scope of the police power limitation would have been raised. The economic substantive due process cases represent the displacement of concerns properly within the ambit of the contract clause.

With that established, the case rightly turns on the police power exception on which it was argued. As understood in *Lochner*, the police power encompassed any bona fide health statute, even if it interfered with freedom of contract. The debate, both in the Supreme Court and in the New York Court of Appeals,⁸⁴ was directed to the question of whether the maximum-hour statute was such a bona fide health statute. Everyone but Holmes assumed that if the legislation were not a health statute, but only a labor statute, then it should be struck down.⁸⁵ Thus the Supreme Court in *Lochner* accepted without question the constitutional validity of extensive statutory control over ventilation and other conditions within the workplace where the substantive connection with health and safety was manifest. To read *Lochner* as a wholesale constitutional endorsement of freedom of contract in all areas of social and economic life is to ignore those portions of the New York statute that were upheld by common consent.⁸⁶ It is also to characterize

⁸⁴ *People v. Lochner*, 177 N.Y. 145, 69 N.E. 373 (1904) (affirming the conviction by a four-to-three vote), *rev'd sub nom. Lochner v. New York*, 198 U.S. 45 (1905).

⁸⁵ This point is made very clear by the majority opinion of Justice Harlan in *Adair v. United States*, 208 U.S. 161 (1908), striking down a statute making it unlawful for employers to demand that their employees not be union members. In his opinion in *Adair*, Harlan noted that his difference with Justice Peckham in *Lochner* was only on the question of whether the baker's statute was a health measure, justifiable as a means of controlling the level of harmful inhalations of baker's dust. *Id.* at 174. He could find no conceivable health rationale in *Adair* and so struck down the statute at issue in that case. Because *Adair* involved a federal statute, it was not governed by the contract clause, but its logic made the parallel decision invalidating a similar state statute in *Coppage v. Kansas*, 236 U.S. 1 (1915), a straightforward matter under the clause. The Court consistently adhered to the line between labor and safety. Shortly after *Coppage*, the Court unanimously sustained workers' compensation statutes in *New York C.R.R. v. White*, 243 U.S. 188 (1917). Justice Pitney wrote for the Court in both *Coppage* and *White*.

⁸⁶ Besides setting maximum hours, the statute regulated drainage and plumbing in bakeries, and all requirements dealing with "rooms, furniture, utensils and manufactured products." *Lochner*, 198 U.S. at 46 n.1. Only the maximum-hour regulation was mentioned in the indictment. Peckham's opinion notes that the additional requirements "may be wise and valid regulations" but then rightly adds that the validity of the hours regulation must be judged in terms of its marginal impact:

Adding to all these [other] requirements, a prohibition to enter into any contract of labor in a bakery for more than a certain number of hours a week, is, in our judgment, so wholly beside the matter of a proper, reasonable and fair provision, as to run counter to that liberty of person and of free contract provided for in the Federal

the work of the Court not by its own words, but by Holmes's lonely dissent, which, if coherent at all, only adopted the view that the legislature has well-nigh plenary power over economic and social affairs, a conclusion flatly inconsistent with any charter of limited government.

Ironically, the real difficulty, squarely raised by *Lochner*, runs in quite the opposite direction. *Lochner* may well have given *too much* scope to the police power, for it can be argued that there is no reason to interfere with freedom of contract, even for reasons of health, where no third-party interests are at stake.⁸⁷ But even assuming that the police power extends to all matters of health and safety, it does not sanction wholesale interference with financial arrangements, such as is mandated by a minimum-wage law. These statutes can impose heavy burdens upon both employer and employee for the benefit of parties who are strangers to the relationship—organized labor, for example, whose members are in competition with nonunion workers. To uphold minimum-wage legislation may be to invite, in the name of the police power, the very rent-seeking that any theory of limited government is designed to avoid. To be sure, rent-seeking may also take place with health legislation since firms may lobby for health and safety measures that impose disproportionately onerous burdens on their rivals. But the danger of political abuse even on matters of health and safety does not justify expanding the police power beyond the scope it assumed in *Lochner*. The danger suggests, rather, that even health or safety measures may be attacked, notwithstanding the soundness of their ends, where the means chosen sweep too broadly. Additional tests might be developed, similar to those that have emerged in connection with other areas of modern constitutional law, to scrutinize the fit between the means selected and the limited class of ends to be served.

Constitution.

Id. at 62.

Justice Harlan's dissent does not address the point of marginal deterrence. Instead, Harlan treats the hours legislation as though it were the sole safeguard, and then contents himself with a recitation of studies that speak to the occupational diseases common to bakers, referring in one instance to the decimation of bakers in Marseilles, France in the plague of 1720, before, it seems clear, any health regulations were in effect. *Id.* at 69-72 (Harlan, J., dissenting).

⁸⁷ See *supra* notes 79-80 and accompanying text. The state claimed there were third-party interests in *Lochner*, chiefly those of the consumers of bread who might be protected by the shorter work hours. 198 U.S. at 62. But these persons are not third parties: they are in the web of contracts with the producer of goods. Even if they were strangers, the relationship between the statute and the asserted evil is clearly tangential to their concerns.

Since *Lochner*, the Supreme Court cases have made no principled effort to define the proper scope of the police power. Perhaps the most critical of the cases is the watershed decision of *Home Building & Loan Association v. Blaisdell*,⁸⁸ on which the modern interpretation of the contract clause rests. There the state had passed comprehensive legislation designed to assist present mortgagors by deferring their payment obligations while allowing them to remain in possession, all without the permission of the lender. The postponement of foreclosure was understood by everyone to vary the terms of *existing* mortgage arrangements and thus to be caught *prima facie* by the contract clause. Chief Justice Hughes, noting the calamitous circumstances of the Depression, concluded that the police power limitation on the scope of the clause accommodated the social pressures of the day. Even if the emergency did not create the power, he argued, it afforded the occasion for its proper exercise. In setting out his position, Hughes was drawn back to first principles of constitutional interpretation, which he resolved in a fashion congenial to state power:

It is no answer to say that this public need was not apprehended a century ago, or to insist that what the provision of the Constitution meant to the vision of that day it must mean to the vision of our time. If by the statement that what the Constitution meant at the time of its adoption it means to-day, it is intended to say that the great clauses of the Constitution must be confined to the interpretation which the framers, with the conditions and outlook of their time, would have placed upon them, the statement carries its own refutation. It was to guard against such a narrow conception that Chief Justice Marshall uttered the memorable warning—"We must never forget that it is a *constitution* that we are expounding"—"a constitution intended to endure for ages to come, and consequently, to be adapted to the various *crises* of human affairs."⁸⁹

The passage contains some of the most misguided thinking on constitutional interpretation imaginable. The operative assumption seems to be that questions of constitutional law are to be answered according to whether or not we like the Constitution as it was originally drafted. If we do not, we are then free to introduce into the

⁸⁸ 290 U.S. 398 (1934).

⁸⁹ *Id.* at 442-43 (citations omitted) (quoting *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 407, 415 (1819)).

document those provisions that we think more congenial to our time. The opinion denies that any cognitive processes are effective to reach the meaning of a clause as written or to understand those implied exceptions that are consistent with its basic structure. It thus removes inquiry into meaning from the realm of interpretation and asks instead whether the Constitution as written comports with the "vision of our time," without ever specifying, with the present diversity of opinion, who "we" are. By this standard a court can invest itself with the power of a standing constitutional convention. The importance of a fixed constitutional framework and stable institutional arrangements is necessarily lost once the framework that was designed to place a limit upon politics becomes the central subject of the politics it was designed to limit. Perfect understanding, like perfect objectivity, may be difficult to obtain, but it will never even be approached by those who do not make the effort to obtain it. Why bother with a constitution at all if it is to be rewritten anew in each generation?

What makes Hughes's entire passage more ironic is its misplaced reliance upon Marshall's powerful prose in *M'Culloch*. Marshall, urging in *M'Culloch* that the various clauses of the Constitution receive their full force, had given the "necessary and proper" clause⁹⁰ an expansive construction that enlarged grants of power to Congress under Article I. Nothing in such reasoning requires a narrow or indecisive construction of provisions, like the Bill of Rights and the contract clause, that limit the power of government. Indeed, Marshall himself, dissenting in *Ogden v. Saunders*,⁹¹ gave a broad and powerful reading to the contract clause, consistent with his view of the United States as a commercial republic.⁹² How strange the twists of history that Hughes should invoke Marshall's canons of construction on behalf of a view so contrary to Marshall's own.

None of the foregoing is to insist that the decision in *Blaisdell* was necessarily wrong on its facts. The critical issue here is how one argues to the outcome in the particular case. Hughes's error lay in insisting that a change in social conditions required a change in the meaning of a text. The task, rather, was to take into account the vast social dislocations of the Depression without abandoning a principled account of the police power limitation. Such an argument would attempt to show how a change in social and economic

⁹⁰ U.S. CONST. art. I, § 8.

⁹¹ 25 U.S. (12 Wheat.) 213, 332 (1827) (Marshall, C.J., dissenting).

⁹² See *id.* at 334.

conditions could give rise to a novel application of a settled legal principle whose meaning remained wholly unchanged. It is at this level that *Blaisdell* is an extraordinarily difficult case.

In order to understand the mortgage moratorium statutes, it is critical to identify two separate reasons that mortgagors might offer to justify postponing the payment of their debts. The first is that they seek relief from bad bargains. Yield to this demand, and unilateral regret alone justifies legislative nullification of contractual rights. The contracts clause thus becomes a dead letter. The proper approach is otherwise. If one party cannot impose a contractual obligation against the will of another, neither can he wholly repudiate the obligation once created. To do so he must obtain the consent of his promisee, not the blessing of the legislature.

The second line of reasoning notes that farmers during the Depression were in desperate straits not because of their own imprudence but because of the massive deflation that the federal government had brought on by contracting the money supply. The intervention was needed to offset not market forces, but state intervention. The net economic consequence of the (unanticipated) deflation was to provide creditors with windfall transfers from their debtors. It was just as though (literally, not figuratively) the federal government had decided to double the size of each individual mortgage debt, the value of money being held constant, without the consent of the debtor. The mortgage moratorium statute at issue in *Blaisdell* represented an awkward, perhaps even clumsy, effort at the state level to undo the mischief brought on by federal action. The state statute can be justified not as an effort to correct market outcomes, but as an effort to correct government misconduct—meddling with private contracts—that falls within the traditional confines of the police power. No one would doubt, after all, that the state could take measures to prevent a private party, *C*, from increasing the debt owed by *A* to *B*. Neither can the government play the part of *C*.

On this analysis, the result in *Blaisdell* clearly serves the ends of the police power limitation. The statute tends to restore the original contractual balance that had been undone by government action. The more difficult question concerns the fitness of the means chosen to neutralize the effects of the deflation. There is no evidence on the record that the mortgage moratoria merely neutralized the effects of the deflation, restoring the parties to the position that they would have enjoyed without the deflation. The correction in fact may have been too little or too great; without detailed evidence it is quite impossible to say which. The deflation

may have been partially anticipated, weakening the case for further correction. The *Blaisdell* legislation, moreover, addressed only part of the problem created by the massive deflation, for it did not reach the financial arrangements that the mortgagees relied upon to obtain their own funds. If one assumes that the banks in question had borrowed money on notes of the same maturity as their outstanding mortgages, so as to insulate themselves from the shifts in underlying interest rates, then the effect of the statute is to deprive them of the hedge that lay at the core of their financial strategy, for their own obligations continue unimpaired though their sources of funds have been disrupted. This is not to say that the decision in *Blaisdell* was necessarily wrong. Even the best efforts of state government to correct for mistakes in federal monetary policies may induce enormous and inevitable errors, which may or may not be greater than those that result from leaving bad enough alone. It may be that the state statute in *Blaisdell* should have been struck down in order to force a more comprehensive solution at the federal level. It may be that the *Blaisdell* statute should have passed muster even though other statutes, with provisions still more draconian, were struck down.⁹³ However these questions may be resolved, they highlight the fact that the *Blaisdell* case was extremely difficult not because of anachronistic constitutional doctrine but because of the intrinsic complexity of the world.

Justice Hughes, however, rather than confronting the difficulty of the facts, chose to manipulate the doctrine. The subsequent history of the police power limitation on the contract clause reflects the costs of that choice. Had Hughes written the right kind of opinion, *Blaisdell* would have reflected an inevitable struggle with an intractable set of facts, but the opinion would have announced no broad interpretive principle. The police power exception would not have been transformed into an open invitation to private rent-seeking. Instead, *Blaisdell* trumpeted a false liberation from the constitutional text that has paved the way for massive government intervention that undermines the security of private transactions. Today the police power exception has come to eviscerate the contracts clause.

One recent case illustrates the poverty of current judicial thinking on the police power. In *Exxon Corp. v. Eagerton*,⁹⁴ an Al-

⁹³ Compare *Blaisdell* with *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935) (invalidating under contract clause legislation significantly reducing remedies available for municipal bondholders).

⁹⁴ 103 S. Ct. 2296 (1983).

abama statute imposed a severance tax upon oil and gas extracted within the state. The statute then exempted royalty owners from the imposition of the tax, and provided that the tax could not be passed forward to consumers, both statutory provisions to apply even where the provisions of existing contracts required otherwise. No party challenged the provisions of the severance tax itself, although the arguments for so doing are far from idle.⁹⁵ Instead the challenge was directed solely to the provisions prohibiting the pass-through of the tax under existing royalty and consumer contracts. In upholding the statute as an exercise of the police power, the Court reasoned:

[T]he pass-through prohibition did not prescribe a rule limited in effect to contractual obligations or remedies, but instead imposed a generally applicable rule of conduct designed to advance "a broad societal interest" [citing *Allied Structural Steel Co. v. Spannaus*⁹⁶], protecting consumers from excessive prices. The prohibition applied to all oil and gas producers, regardless of whether they happened to be parties to sale contracts that contained a provision permitting them to pass tax increases through to their purchasers. The effect of the pass-through prohibition on existing contracts that did contain such a provision was incidental to its main effect of shielding consumers from the burden of the tax increase.⁹⁷

The Court's explanation does not rest on any coherent vision of the contract clause. The opinion makes it quite clear that retroactive legislation is generally permissible so long as the state takes the simple precaution of having its legislation apply *in futuro* as well. The *Egerton* holding, moreover, flouts the majority position in *Ogden v. Saunders*, since the Court in *Egerton* did not even consider striking down the the Alabama statute as applied to existing contracts. More central to the present analysis, *Egerton* adopts an account of the police power broad enough to sustain every conceivable piece of state economic regulation. Regulation always produces winners and losers; without winners how could it

⁹⁵ See *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981), in which the Court by a six to three vote turned aside a challenge to a special state severance tax. The *Commonwealth Edison* decision is defended in Hellerstein, *Constitutional Limitations on State Tax Exportation*, 1982 A.B. FOUND. RESEARCH J. 1, 54-59. For a criticism of the decision, see Epstein, *supra* note 2, at 445-49.

⁹⁶ 438 U.S. 234, 249 (1978). For a discussion of *Spannaus*, see *supra* text accompanying notes 50-56.

⁹⁷ *Egerton*, 103 S. Ct. at 2306.

pass? If consumer protection against "excessive prices" falls within the scope of the police power, then so too does producer protection against "inadequate" prices, whether effected by subsidy, deregulation, or, in the present example, by repeal of the severance tax itself. It scarcely matters that "excessive" or "inadequate" remains undefined, for no matter what is done, no matter who wins, the legislation satisfies the demands of the police power. The evil to which the clause is directed—the transfer of wealth by special-interest politics—is thereby given free rein.

The Court in *Egerton* sought to justify the legislation by noting that its provisions apply to "all oil and gas producers."⁹⁸ Yet on this point, at least, the argument runs into the teeth of the contract clause: "No state shall . . . pass any . . . Law impairing the Obligation of Contracts."⁹⁹ The words "pass any law" encompass such general legislation as well as legislation favoring a single producer. Indeed, the very fact that the Alabama legislation pits consumers, producers, and royalty owners against each other reinforces the need for judicial intervention. Otherwise, the statute effectively becomes a tool whereby a successful faction is able to ensure a payoff to all of its members. *Egerton*, on its facts, is a textbook case in which the Constitution requires judicial nullification of legislation, even by a court that denies the contract clause any prospective application. *Egerton*, as decided, is a clear example of how the unprincipled manipulation of necessary limitations on the contract clause can lead to the judicial nullification of the constitutional text.

2. *Just Compensation.* The police power is not the only exception that must be read into the contract clause in order to give it structural coherence. Marshall's canon of construction that warns against "mischievous" effects requires that a just compensation exception also be read into the clause, a step that applicable precedent confirms. In *West River Bridge Co. v. Dix*,¹⁰⁰ the state had conveyed the franchise for a bridge to the West River Bridge Company by charter. Years later, the state sought to condemn the franchise and the bridge. The company argued that the contract between it and the state was protected by the contract clause, and would be impaired, even upon payment of just compensation, if the state were permitted to condemn the property.¹⁰¹ If the express

⁹⁸ *Id.*

⁹⁹ U.S. CONST., art. I, § 10, cl. 1.

¹⁰⁰ 47 U.S. (6 How.) 507 (1848).

¹⁰¹ *Id.* at 516-18.

language of the clause precluded implied exceptions, then the challenge to the state condemnation would succeed. Certainly, if a private party attempted to rescind a conveyance (be it of tangible property or a franchise) upon payment of its fair value, its actions would be regarded as a breach. The remedies for breach, moreover, encompass, contrary to Holmes's famous dictum,¹⁰² not only damages, but also, in the appropriate case, specific performance. Why should the state stand in any better position than does the private party?

Dix contains an enormous amount of judicial huffing and puffing to avoid the conflict between the language of the constitutional text and the assertion of state power. Its only effect, however, is to rob the word "impair" of all of its objective content:

But into all contracts, whether made between States and individuals or between individuals only, there enter conditions which arise not out of the literal terms of the contract itself; they are superinduced by the preexisting and higher authority of the law of nature, of nations, or of the community to which the parties belong; they are always presumed, and must be presumed, to be known and recognized by all, are binding upon all, and need never, therefore, be carried into express stipulation, for this could add nothing to their force. Every contract is made in subordination to them, and must yield to their control, as conditions inherent and paramount, whenever a necessity for their execution shall occur. Such a condition is the right of eminent domain. This right does not operate to impair the contract effected [sic] by it, but recognizes its obligation in the fullest extent, claiming only the fulfilment [sic] of an essential and inseparable condition.¹⁰³

In an odd sense the language (but not the result) in *Dix* anticipates Justice Hughes's approach to constitutional interpretation in *Blaisdell*.¹⁰⁴ In an effort to avoid the effective strangulation of government by the contract clause, the Court veers quickly to the other extreme. Every contract ceases to be a product of the joint

¹⁰² See O.W. HOLMES, *THE COMMON LAW* 301 (1881) ("The only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass."). Holmes tried to defend this view by stating that his proposition did not deal with the role of courts of equity. Pollock made an effective reply to Holmes's belated defense. See Letter from Sir Frederick Pollock to O.W. Holmes (September 17, 1897), reprinted in 1 HOLMES-POLLOCK LETTERS 79-80 (M. Howe 2d ed. 1961).

¹⁰³ 47 U.S. at 532-33.

¹⁰⁴ See *supra* notes 88-93 and accompanying text.

will of the parties and is subject instead to some higher law or higher authority. The Court, pretending that damages and not specific performance is the "fullest" discharge of contractual rights, waters down enormously the potent definition of impairment provided by Justice Washington in *Green v. Biddle*.¹⁰⁵ The objection to *Dix* is not that the Court reads a just compensation exception into the contract clause, but rather that it insists that this objective can be achieved by a fuller explication of the meaning of the term "impair." Based on the language in *Dix*, we know only that the eminent domain power is a condition that the state imposes on all contracts. The reasoning of the case, however, provides no reason to make it the only such condition. The Court's unnecessary appeal to higher law has an inexhaustible power, for bad as well as good. If it can allow the abrogation of contractual terms upon payment of just compensation, then it could also allow the abrogation of the contract without compensation. We are one step further down the road toward reading into both public and private agreements whatever "master term" the court sees fit.

The only way to avoid the problem created by *Dix*, and to restore analytical clarity, is to preserve the distinction between situations in which one *denies* that the abrogation has taken place, and situations in which an explicit *justification* is offered for an admitted abrogation of contract, be it public or private. The burden of justification falls on those who wish to establish the implied exception by showing how it is consistent with the animating conception of the contract clause. While the broad rhetoric in *Dix* is inconsistent with any system of constitutional limitation, the just compensation exception can meet the required standard of justification, given the "mischief" that follows in its absence.¹⁰⁶ If the exception were denied in *Dix*, then the power of eminent domain would be lost whenever land is conveyed by private deed. After all, if the contract clause prevents the impairment of contracts with the state, then it also prevents the impairment of contracts between private parties. The state, therefore, would be unable to condemn any land to which a purchaser had received indefeasible title from a private vendor. An implicit just compensation limitation, however, respects the basic structural integrity of the constitutional limitation while restoring a sensible balance between the protection of property and government power. Such a limitation allows the state to impair contracts only so long as the holder of contrac-

¹⁰⁵ 21 U.S. (8 Wheat.) 1, 84 (1823), *quoted supra* text accompanying note 49.

¹⁰⁶ See *supra* note 38 and accompanying text.

tual rights is left at least as well off as he was before the impairment. No government required to pay for whatever it takes for its own use can be said to have arbitrary power. Quite the opposite is true of a government that may unilaterally insert whatever provisions it chooses into its own contracts or those of private parties.

Dix itself dealt with the need for a just compensation exception in the case where the force of the government is directed against a single claimant. The need for the exception, however, is broader. Properly understood, the just compensation exception extends beyond a case like *Dix* to explain the power of the state to vary, by general regulation, the rules that govern the enforcement of contracts generally, so long as the regulation itself provides matching benefits to the same individuals whose contractual rights are limited by the regulation. The exception is necessary for this broader purpose even if the contract clause is confined to retroactive application. It would be most inconvenient and foolish if a general contract statute regulating, for example, the admissibility of parol evidence, could never be applied to agreements that were entered into before its passage. If such a statute is stated in neutral terms, then it is as likely to benefit one party to an agreement as it is the other. Since it is unlikely, given such neutrality, that political coalitions will form to secure the statute's passage, the validity of the statute should be presumed, subject to a showing that its passage was designed to alter the result in a single case or in a group of cases all turning on a common issue.

The just compensation exception also has a powerful role to play in legitimating interference with prospective agreements. Statutes of limitations, a matter of concern in the original debates over the scope of the clause, provide an instructive example.¹⁰⁷ The justification of the police power offered in this article lends some support to statutes of limitations as devices to prevent frivolous and fraudulent complaints. But the case for their constitutionality is buttressed by an appeal to the just compensation exception, here as regards prospective impairments of contract. A general and prospective statute of limitations for contract actions does not afford any effective medium for the redistribution of wealth and opportunities through the political process.¹⁰⁸ In sharp contrast to mort-

¹⁰⁷ See *supra* text accompanying note 22.

¹⁰⁸ Changes in the statute of limitations for actions that have already accrued, however, can have a redistributive effect, whether they reopen the limitation period for actions already barred, or shorten it for suits that have not yet been brought. For my views on the subject, see Epstein, *supra* note 2, at 442-43.

gage moratoria, or to a restraint on competition, a statute of limitations does not create a distinct class of winners and a distinct class of losers. Because it bars stale claims, it encourages the immediate enforcement of all claims, thereby reducing the costs of litigation and increasing the reliability of outcomes. By setting precise periods and giving general notice it permits everyone to mitigate his losses. Where the statute applies generally, moreover, the costs it imposes will be diffused over the population at large. Indeed, it is quite impossible to isolate individuals on whom, *ex ante*, a general statute of limitations imposes special costs. Because it is hard to see how such a statute could be the source of rents, its enactment can be thought of as advancing the general welfare, and very likely the interests of all individuals, be they merchants or consumers. The benefits that each person derives from the statute can be understood as compensation provided by the state for the loss of the rights in question. To the extent that statutes of limitations improve overall welfare, there is good reason to believe that the compensation for the rights they bar is sufficient.

The logic that justifies statutes of limitations can be used to justify other forms of legislative intervention that *prima facie* violate the contract clause. For example, there are no real distributive gains to be achieved by one party or another from the manipulation of the doctrine of consideration,¹⁰⁹ the parol evidence rule, or the rules for the recordation of land transactions.¹¹⁰ Moreover, this justification for exceptions to the prospective application of the contract clause helps to explain why the prospective application of state insolvency laws at issue in *Ogden v. Saunders*¹¹¹ presented such a difficult issue. The common premise of both Washington's opinion for the Court and Marshall's dissent was that if the contract clause applied prospectively, then it functioned as an absolute prohibition on regulation of contract.¹¹² If forced to the choice

¹⁰⁹ See Epstein, *The Social Consequences of Common Law Rules*, 95 HARV. L. REV. 1717, 1744-49 (1982).

¹¹⁰ In *Jackson v. Lamphire*, 28 U.S. (3 Pet.) 280, 289 (1830), the Court upheld the power of the state to enact a recordation system notwithstanding the contract clause. The result in the case is correct, but the opinion itself is only a collection of platitudes. Properly analyzed, the statute is an impairment of contract (the failure to register defeats the otherwise valid title), but one for which there is implicit compensation in kind arising from the widely-shared benefits of increased marketability. Statutes that require the recording of interests conveyed before their passage raise very different questions. Such a statute was sustained in *Texaco, Inc. v. Short*, 454 U.S. 516 (1982). For a criticism of that statute, see Epstein, *supra* note 65, at 373-78.

¹¹¹ 25 U.S. (12 Wheat.) 213 (1827). See *supra* note 46 and accompanying text.

¹¹² See 25 U.S. (12 Wheat.) at 261 (Washington, J.), 334 (Marshall, C.J., dissenting).

between an absolute and a solely retroactive prohibition, it is easy to see why a court would confine the operation of the contract clause to retroactive application, even in the face of the increased opportunities for legislative abuse that the narrow decision would spawn. But once *Dix* made clear that the just compensation limitation is implicit in the clause, it became possible to escape the difficult choice presented by *Ogden*. One may agree with Marshall that the clause has prospective application, and nevertheless uphold the *Ogden* statute on the grounds that a general insolvency law provides just compensation for the rights it abrogates. Since no one can tell at the outset who will need the law, everyone stands to benefit to some degree if debtors do not have to surrender to their creditors the proceeds of their future labor. Because the statute on its face thus provides implicit compensation to all the individuals it governs, a successful challenge must depend upon showing that *ex ante* some groups will receive differential benefits in practice. The hard question, whether insolvency legislation should be classified with statutes of limitations or with such forms of anticompetitive legislation as minimum-wage laws, requires close attention to the details of the particular statute in question. There is, for example, ample reason to sustain an insolvency law if its operation is confined solely to traders; there is still much reason to sustain it if it applies to all debts, however incurred; but there is far less reason to sustain it if it releases only consumer borrowers from commercial lenders, for even though the lenders can mitigate their losses, it is doubtful that they can eliminate them. A fuller inquiry into the subject may lead people to differ on where to place the line between permissible and impermissible insolvency statutes, for it is quite impossible in practice to demand a perfect match between the burdens imposed by legislation and the offsetting benefits derived from it. But no matter on which side of the line any particular insolvency statute is determined to fall, the just compensation exception provides the analytical anchor for its proper evaluation.

The explicit recognition of the just compensation exception sheds light on other important features of contract law. With the exception firmly secured, for example, it is no longer necessary to rely exclusively on the police power to regulate contracts once they have been formed. This new avenue of legitimate regulation helps to avoid the most basic difficulties. Suppose the legislature enacts a Uniform Commercial Code provision that changes the scope of the parol evidence rule. Is there any reason why this change should not apply to a long-term contract entered into before the adoption of the statute? The answer to this question depends upon whether

the statute appears to work a systematic redistribution in favor of one identified group of individuals or another. Since it is highly doubtful that the retroactive change would have such an effect, for reasons canvassed above, the statute should pass muster under the contract clause. The just compensation exception thus increases the freedom that the legislature has, and should have, to regulate existing contracts.

The just compensation exception also makes it possible to understand a distinction that has bedevilled interpretation of the contract clause from the middle of the nineteenth century: a change in the contractual right was thought to run afoul of the clause, while a "mere" change in the applicable remedy was not.¹¹³ As a formal matter the distinction is incoherent, for any change in the nature of the remedy is itself a change in the rights of the parties under the contract. As the case law developed in the nineteenth century, the distinction was confined to contracts already in effect (given that *Ogden v. Saunders* had denied the prospective application of the clause), where it was reduced in effect to a question of degree: the larger the interference, the more likely the invalidation of the impairing statute. The distinction, attributable to the perceived need to make ad hoc exceptions to the contract clause, even when confined to retroactive application, has long been criticized as obscure,¹¹⁴ and so it is. The explicit acknowledgment of the just compensation exception helps to explain how the distinction arose and why it was unavoidable. Because the statutory schemes challenged in the nineteenth-century cases often provided no explicit compensation, the courts were reduced to very rough proxies to decide whether or not a given interference with contract should be accepted. One rough guide was the size of the loss suffered by the regulated party: if that loss was great, then the likelihood was that there was no return benefit to the party sufficient to compensate it. So understood, the distinction between interference with remedy and with basic obligation may be seen as an imperfect proxy for assessing the justness of the compensation provided by the challenged statute in cases that do not squarely acknowledge the existence of a just compensation exception. The distinction, however, becomes evidentiary, and not ultimate, once the proper scope of the just compensation exception is acknowledged, and the analysis may proceed on a coherent basis. The criti-

¹¹³ See, e.g., *Bronson v. Kinzie*, 42 U.S. (1 How.) 311, 315-18 (1843). See generally B. WRIGHT, *supra* note 12, at 69-71.

¹¹⁴ See, e.g., *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56, 60 (1935) (Cardozo, J.).

cal question, as always, is whether the proposed statute is the source of special gains to a particular faction. The same inquiry animates the interpretation of both the scope of the written clause and the implied exceptions to it.

At this point the parallels between the just compensation element of the contract clause and the eminent domain clause should be evident enough, and the question arises whether any distinction between the two of them can exist. That some overlap must be found seems apparent, so long as contractual rights are regarded as a species of property. One could try to make the two clauses coterminous by arguing that any statute, regulation, or tax that restricts the use of property necessarily limits the power of disposition over it, and hence is an impairment of contract. But on balance it seems that while the contract clause prevents one major type of legislative abuse, it does not reach all such abuses, as does the eminent domain clause, properly construed.¹¹⁵ The contract clause, properly interpreted, protects rights of disposition over things, whether exercised before or after the challenged legislation is passed. Zoning restrictions on land use, of course, may well impose heavy "burdens" on the right of sale, but it is doubtful that such restrictions are reached by the contract clause, which simply does not govern all aspects of social life in which factions can operate. It is enough, however, that the contract clause imposes a powerful constraint on government actions within its limited domain: the right to dispose of property on terms thought fit to its owners.

F. Judicial or Legislative Activities

We come finally to the sixth question: does the contract clause reach only legislative activities or does it limit the judiciary as well? The express language of the clause argues for a narrow interpretation. The phrase "[n]o State shall . . . pass any . . . Law" clearly suggests that only legislation is covered, not judicial activity.¹¹⁶ Two other very powerful considerations buttress this conclusion. First, interpretation of the contract clause has been animated by concern about legislative factions and their rent-seeking activities. There is little prospect of factional abuse attending upon the question, for example, of whether some ideal law of contracts is impaired by the insistence upon consideration, or indeed by the

¹¹⁵ See Epstein, *supra* note 2, at 437-38 & n.12.

¹¹⁶ See *Tidal Oil Co. v. Flanagan*, 263 U.S. 444 (1924), where the Court noted: "The language, 'No State shall . . . pass any . . . law impairing the obligation of contracts'—plainly requires such a conclusion." *Id.* at 451 (emphasis in original).

abrogation of the requirement. Since the questions it decides are innocuous, at least in constitutional terms, the judiciary properly is outside the ambit of the contract clause. Second, if the state judiciary lies outside the scope of the contract clause, the routine growth and development of the common law of contract can proceed at the state level wholly without the influence of federal constitutional law principles. The Constitution as drafted, after all, does not provide for federal scrutiny where none is needed.

Other arguments, however, pull in the opposite direction. Like the contract clause, the first amendment—"Congress shall make no law . . . abridging the freedom of speech"¹¹⁷—appears on its face to limit only legislative action. Indeed the scope of the prohibition is narrower than in the case of the contract clause, because the contract clause refers to the "State" while the first amendment refers to "Congress," the legislative branch of the federal government. Yet the first amendment has long received a broader interpretation. It was applied, for example, to the judicial contempt citations in *Bridges v. California*.¹¹⁸ In a more dramatic development, the Supreme Court in *New York Times Co. v. Sullivan*¹¹⁹ held that the first amendment prohibits common law actions of defamation against public officials unless "actual malice" is proved. The Court reasoned that since matters of text were dominated by considerations of function, it would be not only odd but dangerous to permit large common law judgments while preventing small statutory fines for the same conduct.¹²⁰

The basic principle that emerges from cases like *Bridges* and *Sullivan* is that where judicial action is a close substitute for legislation, a prohibition against the latter must reach the former. In light of the behavior of modern courts, for whom the nullification of contracts is a commonplace event, the abuses so feared are not limited to legislation. The appointment of state judges is often a very political matter precisely because it is understood that they will act in ways that the framers would themselves have regarded as legislative.

Given the modern role of the judiciary, what should be done about the contract clause? The decided cases¹²¹ provide no decisive

¹¹⁷ U.S. CONST. amend. I.

¹¹⁸ 314 U.S. 252 (1941).

¹¹⁹ 376 U.S. 254 (1964).

¹²⁰ *Id.* at 277-78.

¹²¹ See, e.g., *New Orleans Waterworks Co. v. Louisiana Sugar Ref. Co.*, 125 U.S. 18 (1888); *Commercial Bank v. Buckingham's Ex'rs*, 46 U.S. (5 How.) 317 (1847); see also *Ross v. Oregon*, 227 U.S. 150 (1912) (ex post facto clause does not apply to state judicial

answer to this question. The Supreme Court has consistently set forth the proposition that the contract clause does not apply to judicial action in cases involving an erroneous interpretation of either statutory or contractual matters. Without doubt this position has been, at least in part, animated by the fear that, were any other to be adopted, every state court contract decision would involve a potential constitutional question, making the Supreme Court the forum of last resort for interpretation of individual agreements.¹²² None of the cases, however, addresses the status of judicial action under the contract clause when courts strike down various contractual provisions on supposed grounds of public policy, thereby acting much like legislatures. To be sure, courts are not subject to the same political dynamics as legislatures, but it is at least an open question whether a commendable reluctance to constitutionalize matters of interpretation should carry over to instances of outright nullification of contractual rights.

One recent case dealing with the judicial nullification of due-on-sales clauses found in home mortgages illustrates the dilemma. In California, it was a common practice to insert clauses providing that principal and interest on home mortgages were due upon the sale of the property. Such clauses were expressly upheld by the California Supreme Court,¹²³ and on the strength of that decision virtually every residential lender in the state included the clause in their home mortgages. Several years later the California Court reconsidered the matter and held that due-on-sale clauses were unenforceable except upon a showing that enforcement was necessary to protect the creditor's security, even with respect to mortgages made in express reliance upon its prior decision.¹²⁴ The court's own view was that its decision was not retroactive because it excepted completed transactions in which the creditor had relied upon the

decisions).

¹²² [W]e are not authorized by the Judiciary Act to review the judgments of the State courts, because their judgments refuse to give effect to valid contracts, or because those judgments, in their effect, impair the obligation of contracts. If we did, every case decided in a State court could be brought here, when the party setting up a contract alleged that the court had taken a different view of its obligation to that which he held. *Knox v. Exchange Bank*, 79 U.S. (12 Wall.) 379, 383 (1871).

¹²³ *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

¹²⁴ See *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 953-54, 582 P.2d 970, 976-77, 148 Cal. Rptr. 379, 385-86 (1978). The dissimilarity of judicial and legislative activity in this area is illustrated by the recent federal enactment of the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. 97-320, § 341, 96 Stat. 1505 (codified at 12 U.S.C. § 1701j-3 (1982)), which, with some qualifications, overturns the state decisions invalidating the due-on-sale clauses.

clause to call back the principal. But the court did purport to invalidate the clause in home mortgages made before its decision where the sale triggering the clause occurred after that decision. The wealth shifts created by this ruling are manifest and the decision wholly unprincipled. As judges take upon themselves a greater legislative role, their activities should come under greater scrutiny.

The application of the clause to judicial activity is a nice question indeed. On balance, I am inclined to extend the contract clause to state judicial activities in the same way that it applies to legislatures. But there is an irony here: *Quis custodiet custodiet?* Can we expect state courts in their constitutional guise to limit their propensities at common law? And what will move any court, including the United States Supreme Court, to follow the principles of constitutional construction I have urged if they are subject to pressures similar to those felt by legislatures? The puzzle is an intractable one, but in the end it seems better for the courts to try to govern the activity by reasoned argument than to leave themselves free of all constitutional restraint.

CONCLUSION

There is no question that the contract clause bristles with difficult interpretive problems, but its ambiguities do not confer equal dignity on all interpretations of the clause. The interpretation of the contract clause prevailing in the Supreme Court reduces the clause to yet another emaciated form of substantive due process. Even if we are unable to settle on the correct reading of the clause, we can be certain that the Supreme Court's present interpretation is both wrong and indefensible. This sharp conclusion, moreover, does not depend upon acceptance of the arguments made in this article or elsewhere for prospective application of the clause, for the clause as construed today creates at most a faint presumption against legislative interference with existing contracts. The police power exception is so broadly construed under current law that it engulfs the entire clause.

It would take a major change in constitutional doctrine to adopt the views that I have taken in this article. No court could be expected to adopt the position espoused here within the compass of a single decision even if it agreed with the present analysis. Institutional changes move at a slower pace than academic argument. But with great firmness we can insist upon a change of direction moving toward the revitalization of the contract clause. As the cases come down, particular doctrinal questions will come into focus and the necessary adjustments can be made. The social neces-

sity of institutional caution, however, does not offer even a glimmer of an excuse for decisions like *Eagerton*, whose main achievement is to make a bad body of doctrine even worse. The contract clause is not a technical nuisance to be undermined by clever stratagems and verbal sleights of hand. It is an essential part of our basic constitutional scheme of limited government. It should be so read.