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Unconstitutional Conditions and Bargaining Breakdown

RICHARD A. EPSTEIN*

In this paper, I should like to consider again the doctrine of unconstitutional conditions, which I recently examined at far greater length in my Foreword to the Harvard Law Review's Supreme Court issue.¹ This article should not be regarded as a simple summary of material that has been presented at far greater length elsewhere, for with summary comes clarification, extension, reconsideration, qualification, and defense. My ambition, therefore, is to move the analysis further in two directions, one theoretical and one practical. My first goal is to show how the doctrine of unconstitutional conditions can operate as an effective barrier against the dissipation of the social gains that are otherwise obtainable by collective social action. The second goal is to show how the doctrine of unconstitutional conditions, notwithstanding its nineteenth century origins, continues to play an important intellectual role in modern constitutional theory.

The outline of the paper is as follows. In the first section of this paper, I shall state the dilemma which gives rise to the problem of unconstitutional conditions. In the second section, I shall make explicit the linkage between the problem of unconstitutional conditions and the model of the “Two Pies” that I have developed at length in

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my *Takings* book. In it, I show how the unconstitutional conditions doctrine performs a useful social function even in situations where the Pareto conditions have been met. In the third section, I give five separate numerical examples in order to isolate the types of conditions that raise special questions of unconstitutional conditions, as opposed to ordinary takings problems or, indeed, no constitutional problems at all. The fourth and final section examines the necessary role for the doctrine of unconstitutional conditions both before and after the constitutional watershed of 1937. In that section, I explain why the doctrine of unconstitutional conditions will be a necessary part of constitutional law so long as there are two spheres of government action — one in which there is a presumption in favor of government power, and a second in which there is the opposite presumption in favor of individual liberties. The doctrine arises as an effort to determine the constitutionality of government action which touches upon these two separate realms simultaneously. The exact demarcations between these two domains only tells where the doctrine will surface. But so long as the two domains do coexist, as they must, the doctrine will continue to have as much vitality in the present regulatory environment as it did in the pre-1937 era.

I. WHY UNCONSTITUTIONAL CONDITIONS: THE ALLURE OF THE GREATER/LESSER POWER

Unconstitutional conditions raise one of the few pervasive problems of constitutional law that threads its way through a large number of unrelated substantive areas. The initial query with unconstitutional conditions is disarmingly simple. Why have the doctrine at all? In the usual case, the state is in a position to offer or withhold some benefit to an individual; likewise, that person may accept or reject the benefit at will. The state is under no obligation to supply the benefit in the first instance, so the state is not welching on its obligations by unilaterally imposing new conditions on preexisting arrangements.

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3. Situations where the Pareto conditions are met are those in which someone is made better off and no one is made worse off. See, on the various definitions of social welfare, Coleman, *Economics and the Law: A Critical Review of the Foundations of the Economic Approach to Law*, 94 ETHICS 649 (1984).
4. The 1937 revolution had two sides. The first side concerned the expansion of the commerce clause, on which see NLRB v. Jones & Laughlin Steel Corp., 301 U.S. I (1937), and Wickard v. Filburn, 317 U.S. 111 (1942). The second side concerned the limitation of the protection of economic liberties, on which see West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937). There has been widespread approval of both these trends. For my lonely dissent from the current consensus, see Epstein, *The Mistakes of 1937*, 11 GEO. MASON UNIV. L. REV. 5 (1988).
These two at-will extremes create an extensive bargaining range between the state and the individual. Within that range, the bargains struck should leave both sides better off than before. To use simple numbers, if the state valued “its” holdings at fifty and the individual valued his or hers at thirty, then any agreement between the two which yielded a total value in excess of eighty could be structured to leave both sides better off than before. The resources would be placed where valued most and appropriate cash transfers then made to divide the benefits, such that the state has holdings in excess of fifty and the individual has holdings in excess of thirty. So long as each side has complete power to decide whether to take or leave any conditioned benefit, who should be able to complain?

In the classical economic sense, the new order appears to be Pareto superior to the old, and hence desirable under the standard accounts of social welfare. The untrammeled power to refuse to give consent is protection enough for both the state and the citizen. The greater power to stay out of the deal altogether gives rise to the lesser power to enter into it only if certain conditions are met. Consent, or waiver, thus become the universal solvent that cuts across the various constitutional provisions that protect individual rights. There is good reason for the ubiquitous nature of the greater/lesser argument — and for the unconstitutional conditions riposte.

The model of bargaining adopted here has great staying power because it organizes most of our understanding of ordinary private transactions. For example, the ordinary purchase of a piece of land is reached by bargaining under the greater/lesser logic. If the prospective buyer is willing to pay $100 for the land, he is not obliged to make an initial offer of that amount. Any lesser sum will do, for the greater power not to do business with the landowner encompasses the lesser power to bid any amount, however small. The owner, in turn, protects himself by holding out for a higher price, until a deal is struck. To deny the greater/lesser paradigm its syllogistic force in this context is to set commerce adrift at sea without paddle or rudder. Quite simply, there is no alternative mechanism for any voluntary exchange. The greater/lesser argument is thus the precondition for commerce and trade and has been so in all stages of our nation’s history. It is not an easy target to undermine. So, why should one abandon it in trying to think about the bargains and grants that the state can make with its citizens?
II.  THE PARETO TRAP AND THE TWO PIES

There is no simple answer to the challenge posed by the trap — the Pareto trap — of the greater/lesser argument. I believe that the right way to go about the job is to identify reasons that render this simple, freedom of contract model inadequate in private transactions, and then to identify how those same circumstances arise in the public sphere with the state exercise of power.

In order to see this point, it is useful to revert to a very simple model I used to analyze the operation of the takings clause of the Constitution. It is the model of the Two Pies. The inner circle contains a set of individual entitlements, where the allocation of an individual's shares is well-defined within the legal system. For these purposes it does not matter how that inner circle is defined. It only matters that rights are definite, and that there is general agreement as to who has what, before the government moves into action. Any baseline will do, whether it is based on the common law rights or welfare state entitlements.

The question then arising is: How can the various parties in the initial position improve their original position? With the takings clause, the emphasis is on improving each position through coercive action rendered necessary to overcome the coordination and holdout problems that might arise when large numbers of individuals have to unanimously agree in order to change the status quo ante. Within the Pareto social welfare standard, the only query is whether each person has some slice of the outer ring (in which case the ring itself is necessarily positive). That condition is satisfied when trades are voluntary, given ordinary individual self-interest. There is no reason to worry about the allocation of gain to decide whether the bargain, conditional or not, is socially desirable. The test only requires that it be shown that no one is worse off after the bargain than before, and that at least one person is better off by virtue of that bargain. In practice, both parties will be made better off; otherwise, the bargain will not take place. The total size and distribution of the gain have no place in the traditional austere analysis.

Why not settle for this state of affairs, where the size of the outer ring is positive, and each person bears some fraction of the gain, without imposing any constraints on the distribution of the gain so generated? The usual argument favoring this position is that our inability to make interpersonal comparisons of utility also blocks any effort to decide who should receive a larger, and who a smaller, share of the social surplus from cooperative action. In the context of

5. See supra note 2.
two-person private contracts, there is a great force to this argument, especially when competitive forces channel voluntary agreements into contracts with unique, or near unique, price terms. The surplus will pretty much take care of itself, for if one transaction does not exhaust all possible gains, then others will follow. Therefore, the trick is to reduce the transaction costs, allowing the desirable consequences to follow of their own accord, in yet another application of the Coase theorem.7

This conclusion, however, is not universal because, often times, bargaining problems in the private sphere are large enough to overwhelm the potential gains from voluntary transactions. Two problems come to the fore: monopoly and prisoner’s dilemma games.

A. Monopoly

In many contexts the state does not bargain in a competitive market, where the distribution of surplus is constrained by the threat that citizens may go elsewhere. Max Weber defined the state as that organized group of individuals that exercises a permanent monopoly of force within a given territory.8 This definition itself guarantees that the state has a monopoly on an important resource, so that the nature of the bargained solution is not uniquely determined by the existence of a substantial number of viable alternatives available to private citizens.

Where that monopoly situation exists at common law, the laissez-faire attitude toward private bargains no longer survives. The paradigm “private necessity” case arises where the owner of the dock can exclude the owner of a ship whose life and property are threatened by a storm.9 The scope of the bargaining range here is very large, even when the dockowner does not resort to either force or fraud. Perhaps he is the soul of candor, and says: “I shall make you better off by saving your life if you agree to pay me some exorbitant sum.” Even where the money is paid over, common longstanding law rules

7. Coase, The Problem of Social Cost, 3 J. L. & Econ. 1 (1960). The now celebrated theorem says that where transaction costs are zero, resource allocation will be unaffected by the original assignments of entitlement. Conversely where transaction costs are positive, the original assignment of rights will influence resource allocation by blocking any movement of resources to higher valued use, or by increasing the costs of making the necessary adjustment in rights structures through contract.
have allowed the shipowner to set aside the contract and recover the excess, if any, previously paid over. The dockowner is limited to the rental value of his dock and recovery for any damage inflicted by the unwanted entrant.

The justification for this interference with freedom of contract is to introduce new property rights regimes that will enhance the size of the cooperative surplus, by restraining the opportunistic behavior possible when overt necessity creates a huge bargaining range that one party, the dockholder, is in a position to exploit. The scope of the bargaining range has more than distributional consequences. It will shrink the size of the total gain from rescue, as the parties expend resources and jockey to appropriate the larger share of the surplus. The dangers are well appreciated at an intuitive level, for there is a wealth of private transactions in which parties, who anticipate holdout situations, try to bargain in advance for ways to resolve those difficulties before dramatic confrontations arise. Complex agreements governing salvage at sea are one notable example.10 The agreements governing condominiums and cooperatives are another.11 However, antecedent voluntary contracts are not available in necessity cases between strangers, so the law must supply the needed terms. The best guess, and it is a good guess, is that these are the kinds of agreements that all persons would subjectively find in their interest if they had been in a position to make them.

In this environment, the imposition of the forced exchange is not an effort to override individual subjective preferences by some independent or higher social determination of the good. It is an attempt to honor those preferences in a world in which high transaction costs prohibit their realization through private transactions. It is a perilous undertaking, but there is no way to avoid it, for we cannot assume some “safe” alternative whereby doing nothing better preserves the autonomy of individuals. When voluntary deals are blocked, nonaction could be as destructive as misguided action. Minimizing the various threats to autonomy requires us to control against two types of error, that of not making needed bargains as well as that of making unneeded ones, is all that can be done. It cannot be assumed that standing pat honors the subjective preferences of the participants, especially in life and death situations.

In dealing with constitutional issues we often face, if less starkly, the same type of monopoly situation. The state, for example, has exclusive ownership of its highways. There is a bilateral monopoly between the state and any of its citizens. We cannot assume that

there will be a unique bargaining outcome, and there is a risk that valuable resources will be lost in the process of negotiating the terms and conditions by which any person is allowed access of public roads. Freedom of contract in the private area is limited when the risk of strategic bargaining threatens to consume surplus. The same risk is present in the highway example. The federal government can place an "Hammer lock" over all forms of interstate travel. The doctrine of unconstitutional conditions is the counterweight to bargaining breakdown in the public sphere.

It is not possible in this short space to detail, across the board, how these doctrinal efforts to control monopoly power play themselves out. But it is possible to mention three monopoly type situations in which the doctrine has been invoked, with varying success, in order to limit the power of the government to dissipate the cooperative surplus from its contracts.

In the foreign incorporation cases the doctrine was used to tell states that, while they could exclude foreign corporations from doing business within the jurisdiction altogether, they could not admit them subject to discriminatory taxes and regulations. Here the state monopoly power lies in its ability to admit foreign corporations. For example, there may be a competitive market for charters of national corporations between New Jersey and Delaware. But, there is only one state which can allow a Delaware corporation into New York, and that is New York. Its monopoly power is absolute within this limited sphere.

12. See Hammer v. Dagenhart, 247 U.S. 251 (1918), discussed in Epstein, Foreword, supra note 1, at 40-44. The statute invalidated in Hammer required a firm to comply with the federal child labor statute in all its operations in order to ship any of its goods in interstate commerce. The "Hammer lock" refers to the powerful constraint that this statute places on local operations of the firm in an era where direct regulation of local manufacturing was forbidden to the federal government. With the revolution of 1937, the vexing unconstitutional conditions aspect of Hammer disappears under the remorseless scope of the affirmative commerce power.

13. A variation of the doctrine applies in connection with coercion. Thus suppose that A takes from B's property, and then offers to sell it back for $100. The subsequent transaction viewed in isolation leaves B better off than he was before, so long as he values the thing more than $100. Nonetheless, that second bargain is suspect because it increases the likelihood of the original taking. The situation here involves the common law cases of "duress of goods" because the prior theft vitiates the latter transaction. This theme also appears in the unconstitutional conditions cases in which the government first takes by taxation and then seeks to impose conditions on repayment. For illustrations of this problem, see Bob Jones Univ. v. United States, 461 U.S. 574 (1983); Sherbert v. Verner, 374 U.S. 398 (1963).

A second illustration involves federal efforts to gain control over the instrumentalities of interstate commerce before 1937, when manufacture was regulated only locally within each state. The balance of state and federal power could have been undone if the federal government had used its monopoly power to exclude goods from interstate commerce in order to obtain control over matters, which, according to the original understanding of the Constitution had been reserved to the exclusive domain of the states. Again, the doctrine of unconstitutional conditions was invoked to limit the scope of federal power.

A third illustration involves local use of the highways. If a given state allowed persons to use the highway only if they allowed themselves to be regulated as common carriers, it could, in effect, remove and control the entire private side of the competitive market. Here, too, there is a huge bargaining range between the terms which they can obtain with and without regulation. Again, the doctrine of unconstitutional conditions was initially invoked in order to restrict the scope of the bargaining range in this bilateral monopoly situation, with very little ultimate success.

In each of these cases there are two separate inquiries. The first is the question of whether the circumstances of the case “trigger” the doctrine of unconstitutional conditions. So long as we can find the existence of monopoly power, that question is typically answered in the affirmative. Nonetheless, the presence of monopoly power standing alone is not sufficient to vitiate the consent given to the government’s condition. There is still the further question of “justification” — which must be answered by asking whether the condition in question is designed to skew the distribution of cooperative surplus in favor of one given side or another.

15. See, e.g., The Child Labor Tax Case, 259 U.S. 20 (1922), discussed in Epstein, Foreword, supra note 1, at 40-44.
17. Epstein, Foreword, supra note 1, at 40-47.
19. See, e.g., Stephenson v. Binion, 287 U.S. 251 (1932). This case allowed regulation of private carriers, notwithstanding the earlier decision in Frost, because the applicable “Texas statute in respect of permits deals exclusively with the private contract carrier, and requires the issue of the permit not to him in the imposed character of a common carrier, but in his actual character as a private contract carrier.” Id. at 267-68. In other words, the great purposes of Frost were evaded by two statutes instead of one, as the earlier decision intimated. See Epstein, Foreword, supra note 1, at 52 (which noted the fatal weaknesses of Frost, but which did not refer to Stephenson). I want to thank Kathleen Sullivan for supplying me with the necessary Stephenson reference. Note that Stephenson is a Lochner era case that is far more consistent with the post-1937 deference on economic matters.
B. Prisoner's Dilemma Games

A second variation of this bargaining breakdown theme arises when the state is pitted against large numbers of separate and uncoordinated individuals. In essence, the situation could well be that of the classical prisoner's dilemma game; each party makes private decisions leading to an ultimate outcome that none of them desires. In the classical game, for example, each of two separate prisoners confesses to the crime even though it is in the interest of each to remain silent, so long as he is assured that the other remains silent as well. When that bond of assurance is broken, each person has the incentive to defect from their preferred joint strategy by confessing. Put simply, if the other fellow does not defect, then confession allows me to improve my situation handsomely. If the other fellow does confess, then I have to confess as well to prevent ruinous losses. One dominant, self-interested strategy applies regardless of what the other party does, so we each end up worse off without cooperation than we could have been with it.

A similar situation could arise when the use of government power is directed against many separate and uncoordinated individuals. Indeed the specter of this situation animated the extension of the unconstitutional conditions principle in highway cases. For example, it may well be that each person regards his right to participate in political affairs to be of little consequence. Therefore, if told that he must waive his constitutional rights to freedom of speech in order to use the highways, he might think himself better off for the choice, regardless of whether other individuals waived their free speech rights as well. Nonetheless, all people prefer to have a social order in which speech is not compromised, but protected. If, therefore, the state — or its key officials — faced a unified coalition of the citizenry when it set up the same choice, it would collectively be rejected out of hand. The doctrine of unconstitutional conditions, by precluding the waiver of free speech rights as the price for using the highways, prevents government officials from adopting the strategy of divide and conquer (a strategy appropriate to prisoners, but not to citizens). When the state acts in this manner, consent of the citizen to the condition should not protect the statute.

20. "If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guarantees embedded in the Constitution of the United States may thus be manipulated out of existence." Frost, 271 U.S. at 594. Justice Sutherland's instincts are correct but he offers no explanation as to how the strategy could be successful.
The apparent logic that all (two-party) contracts are Pareto superior between the parties ignores the systematic consequences characteristic of the prisoner's dilemma game. Yet it was the risk of this degenerative social situation that led, if only implicitly, to the adoption of the unconstitutional conditions doctrine. But, as cases like *Frost* indicate, it is far more likely for these destructive social strategies to succeed in economic areas than in political areas. There is too much organized political resistance to a proposal which says "People may use the public highway only if they vote Republican (or Democratic)." (The skeptic might say the only reason they are not tried is that it is clear that they would be struck down.) But, there are surely intermediate cases that require closer attention, such as the demand that persons who use the highways submit to random types of searches and seizures.

### III. PRESERVING THE GAINS FROM COLLECTIVE ACTION

The above cases, then, set the basic framework for analysis. The overall situation can be better understood, I believe, by giving numerical illustrations of the variations that have to be distinguished in the unconstitutional conditions context. Assume for simplicity that there are two groups with identical initial endowments. The government could then exercise its coercive power to introduce any one of the following new states of affairs. How should each of these scenarios be treated under the doctrine of unconstitutional conditions?

#### Scenario I: No Conditions

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<tr>
<th></th>
<th>Group A</th>
<th>Group B</th>
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<tbody>
<tr>
<td>(a) Before regulation</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>(b) With regulation</td>
<td>150</td>
<td>150</td>
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#### Scenario II: Virtuous conditions

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<th>Group A</th>
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<tbody>
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<td>(a) Before regulation</td>
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<tr>
<td>(b) With regulation</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>(c) With regulation and good condition</td>
<td>160</td>
<td>160</td>
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</table>
Scenario III: Oppressive conditions

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<tbody>
<tr>
<td>(a) Before regulation</td>
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<td>100</td>
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<tr>
<td>(b) After regulation</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>(c) Pareto failure</td>
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<td>90</td>
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Scenario IV: Unconstitutional conditions

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<tr>
<td>(b) With regulation</td>
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<td>150</td>
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<tr>
<td>(c) With regulation and good condition</td>
<td>160</td>
<td>160</td>
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Scenario V. Problematic conditions

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<td>(a) Before regulation</td>
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<tr>
<td>(b) With regulation</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>(c) With regulation and problematic condition</td>
<td>170</td>
<td>160</td>
</tr>
</tbody>
</table>

Where we can find that the state has monopoly power, each of the above five situations requires a somewhat different analysis. The first scenario is relatively straightforward. Both sides to the transaction advance equally, so there is an improvement all around. Moreover, so long as the parties remain in lockstep there are powerful reasons to believe that the total size of the gain will be maximized. Hence the disproportionate impact test, which this case so clearly invokes, has the desirable effect of insuring not only that people are left as well off as they were before, but also that they move to the highest possible state of welfare, even without a direct judicial determination of what actions produce that result. The procedural constraint gives the right incentive for the substantive result. There is no problem of

unconstitutional action or of unconstitutional conditions in this setting.

The second scenario indicates a virtuous condition. Here, we can assume that the gains achievable under Scenario I, without the use of any conditions (i.e., the roads are built and everyone may use them) are not altered as the state imposes conditions (i.e., a speed limit or a requirement of service of process). These limitations both help and hurt members of both groups, but for each they help more than they hurt (the highways are safer for everyone). There is therefore a further gain off of both (a) and (b) baselines, and the case is again nonproblematic. The mutual gain assured by the state’s condition is the justification legitimating the use of monopoly power.

The third scenario leaves the individuals in group B worse off after government action than before it. There is no need for a doctrine of unconstitutional conditions to handle this case because no member of group B would ever voluntarily consent to situation (c), given that he is worse off than in situation (a). Therefore, the unconstitutional conditions issue will not arise. The case here does not concern the distribution of cooperative surplus, but rather the simpler question of whether members of group B can claim that they have not received just compensation for their property that has been taken. The case therefore is amenable to invalidation under an ordinary takings analysis, without ever reaching any concern about the size or distribution of the cooperative surplus.

The fourth scenario illustrates where the doctrine of unconstitutional conditions takes grip. There is no question that the final state of affairs is Pareto superior to the initial state of affairs. Hence if the question is whether we have this deal, (c), or no deal, (a), individuals in both groups will accept the deal. Nonetheless, there is both less of an aggregate increase than there was in the regulation without the condition, as in (a), and a skewing of the benefits to group A. The two phenomena are closely related. The doctrine of unconstitutional conditions therefore restricts the alternatives available to the state (i.e., dominant group A) to a choice between the initial unregulated situation and the unconditioned legislation. Now the state will choose the latter given that its own interests are thereby advanced. The doctrine of unconstitutional conditions thus operates to good social purpose when there is a Pareto improvement over the initial state of affairs. This is the paradigmatic case where the greater/lesser power arguments lose their normative force.

The fifth scenario is one in which a condition is imposed which improves matters still further than the unconditional action, but spreads the gain unequally between the individual and the state. In a sense the condition is virtuous because it improves welfare on both sides, but the want of equality in advancement leaves one uneasy
(for in practice it may be difficult to distinguish this case from Scenario III). Here, the hardest question is whether it is worthwhile to take steps to equalize the gain. One possibility is to leave well enough alone, which is surely the right answer if the costs of equalization are greater than ten, because the full gain between (b) and (c) would be dissipated. On the other hand, if equalization (redistribution) was costless, then it would be called for, because neither side should get an advantage that the other is denied. But the case here is a weak one, if only because the equalization transfer produces no overall resource gain or loss. Finally, if the equalization costs are greater than zero but less than ten, there is a problem of whether equity in distribution is worth the shrinkage of the overall pie — a very hard question on which it is not possible to give a principled answer. Happily, situations of this sort present an abundance of riches and are far less critical than cases like those found in Scenario IV.

The hard task is to decide which substantive conditions encountered in practice move us to Scenario II and which to Scenario IV. I have already indicated that the incorporation cases involving discriminatory taxation fall within Scenario IV because the gain itself is unequal. Also, there is reason to fear that some portion of the cooperative surplus in those cases will be competed away by political action.22 The same conclusion is quite clearly the case if the scheme in Frost could go forward, as is today the case.23 Today, there is a manifest departure from the competitive equilibrium which gives an unprincipled advantage to the common carriers. In contrast, the service of process and speed limit cases seem to be relatively straightforward illustrations of Scenario II, for there seems to be no disparate impact lurking behind the formal inequality. Therefore, the basic system, as applied to economic liberties, worked to achieve the ideal of any sound system of collective action: to maximize the total amount of gain achieved by government action. The consent requirement protects individuals from being left worse off than they were before government action, that is, it rules out Scenario III. Nonetheless, it does not rule out Scenario IV, which the doctrine of unconstitutional conditions attacks.

23. See supra note 19.
IV. THE MODERN APPLICATION OF THE UNCONSTITUTIONAL CONDITIONS DOCTRINE

Thus far, this brief analysis has concentrated on the early unconstitutional conditions cases where the Court had some willingness to protect economic liberties and to insure that government provision of a monopoly good was not seized upon to distort competitive equilibria.24 However, it should not be supposed that the doctrine of unconstitutional conditions functions only in that kind of setting; although that assumption could easily be made, since, as a matter of first principle, I believe in both the strong protection of economic liberties and the unconstitutional conditions doctrine. Nonetheless, the two issues are severable. The doctrine of unconstitutional conditions has an important place even in the modern constitutional era.

Historically, the doctrine of unconstitutional conditions broke its teeth in exactly those areas where common law rules were displaced by government regulation, long before the 1937 constitutional watershed. The common law did not treat corporations as though they were natural persons.26 Its basic rules of property, contract, and tort did allow individuals to form voluntary associations for common business purposes, but these were in the nature of partnerships. No voluntary contract among shareholders could limit the liability of that partnership, or its members, to strangers. Yet it was just that limitation on third party rights that is brought about by the familiar corporate doctrine of limited liability.26 Therefore, corporations must turn to state corporate charters to escape the clutches of common law limitations making them “artificial beings” subject to extensive state regulation.27 It was precisely to combat the dangers of allowing local companies to do business at low tax rates while subjecting foreign corporations to higher ones that the doctrine of unconstitutional conditions was created.28 Similarly, even during the so-called Lochner era, state regulation of public utilities was routinely accepted.29 The Interstate Commerce Act introduced the first system of rate regulation, which limited the railroads’ common law rights to charge whatever rates they saw fit.30 Similarly, the original ratemaking

24. See Epstein, Foreword, supra note 1, at 50-51.
28. See, e.g., Western Union Tel. Co. v. Kansas, 216 U.S. 1 (1910), discussed in Epstein, Foreword, supra note 1, at 34-35.
rules were first developed in the last part of the nineteenth century, before the *Lochner* decision itself. Rate regulation was also an integral and unchallenged part of the story in *Frost*. There the question was how regulation of highway transport could be meshed with the right to commence a lawful business, a right protected both at common law and under the Constitution. The unconstitutional conditions question arose because it was settled (wrongly, I believe) that the state, as the owner of "its" highways, had the right to exclude ordinary people from their use altogether. The unconstitutional conditions doctrine emerged precisely because government regulation was a permanent feature of American life. The hard issue it addressed was: How to marry a system of government discretion (the state may keep you off the roads altogether) with a system of protected individual rights, of which economic liberties were an exemplar?

After 1937, economic liberties have received only scanty constitutional protection. But, new forms of constitutional protections were devised, with the doctrinal elaboration of preferred freedoms, fundamental rights, and suspect classifications. These major doctrinal changes have served to redirect the focus of the unconstitutional conditions doctrine.

Two points bear special notice. First, the refusal to protect economic liberties after 1937 repudiates the proposition that in economic affairs ordinary people are the best judges of what bargains are in their mutual interest. Consent may be displaced because of a general belief in "the inequality of bargaining power." It may no longer be overridden solely for cause, that is, in order to counter the perverse consequences of bilateral monopoly or prisoner dilemma problems. Quite the contrary, those problems dominate only in a world where individuals are rational agents, who do know their own welfare, and who can act strategically to advance it. Relax the assumption of individual rationality, as the post-1937 Court does, and we no longer face any puzzle in setting aside voluntary bargains, because we no longer view those bargains as Pareto superior. Instead, they are regarded as exploitive, presumably because they leave

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32. See *Truax v. Raich*, 239 U.S. 33, 41 (1915).
34. The genesis of this development dates to *Carolene Prods. v. United States*, 304 U.S. 144 (1938).
one side (workers, consumers, or whoever) systematically worse off than they were before.\textsuperscript{36} Judged by their consequences, these exploitative bargains are indistinguishable from ordinary cases of theft, in that both types of cases involve practices whereby one side gains while the other side loses. Given the costs of undertaking theft, and of guarding against it, the exploiters systematically gain less than their victims lose.\textsuperscript{37} Therefore, these transactions are unacceptable even under the more relaxed Kaldor-Hicks standard of efficiency.\textsuperscript{38}

Exploitative bargains fare no better. If we reject the assumptions of individual rationality, then the greater/lesser power proposition no longer has any presumptive intellectual force. Bargains themselves are not the greater, so conditional bargains are not the lesser. The search for limited exceptions to freedom of contract, such as the bilateral monopoly case, may be abandoned as unnecessary. Assume exploitation, and “consensual” transactions look exactly like coerced ones. The unconstitutional conditions doctrine drops out of the picture because consent is no longer regarded as sufficient protection against government oppression.

The second consequence of the 1937 transformation has to do with the political legitimation of all forms of the wealth redistribution.\textsuperscript{39} The full protection of economic liberties provided that rights to contract, for example, could be taken from individuals only if they were provided with a full equivalent in exchange. Forced exchanges were allowed to intrude upon the sphere of individual autonomy, but redistribution across the board was not. After the 1937 demise, persons could be made worse off, through regulation and restriction, and have no constitutional complaint.\textsuperscript{40} If persons are not protected against partial confiscation, then it becomes quite impossible to see why they should be entitled to any portion of the cooperative surplus of government action. Stated otherwise, if Scenario III is a perfectly acceptable outcome of regulation, then how can group B complain if

\textsuperscript{36} The locus classicus is still Kessler, Contracts of Adhesion — Some Thoughts about Freedom of Contract, 43 COLUM. L. REV. 629 (1943).


\textsuperscript{38} This standard holds that state of the world 2 is preferable to state 1 if the winners in state 2 could pay compensation to the losers in state 1 and still come out ahead. The test requires only hypothetical compensation, not actual transfers, but like the more demanding Pareto formulas it uses subjective standards of utility. If in state 1, A has 100 and B has 50, then state 2 is Kaldor-Hicks efficient if B has 200 and A has 90 so long as B can make a transfer (here of more than 10 units) which would leave both sides better off than they were in state 1. For an account of the test, see Coleman, supra note 3.

\textsuperscript{39} Note, historically the constitutionality of welfare was settled long before the 1937 transformation, but other prohibitions against redistribution (represented by such cases as Lochner v. New York, 198 U.S. 45 (1905); Adair v. United States, 208 U.S. 161 (1908); and Coppage v. Kansas, 236 U.S. 1 (1915)) did hold until overrun.

\textsuperscript{40} See, e.g., Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1937).
they are left in Scenario IV instead of Scenario II? Unless there is a willingness to protect group B's original endowments, given at level (a), then there can be no question of protecting B's higher level of endowments at level (b). Therefore, there is no reason to protect each person's share of the outer ring if they are entitled to no protection of their share of the inner pie.\textsuperscript{41} Again, the unconstitutional conditions just drop out of the picture.

Nonetheless, the structure of the unconstitutional conditions problem, set out above, continues to apply with full force in modern settings as illustrated by the preferred freedoms that came to the fore after the demise of \textit{Lochner}. Indeed, the vast increase in the number of unconstitutional conditions cases in the post-\textit{Lochner} period suggests that no one today perceives either the problem, or the doctrine, as an anachronism. To the contrary, the post-1937 increase in scope of government activities has given it ever broader sway. But, not in all cases. The key point is that the doctrine will take grip only where the following two conditions are conjoined: (1) There must be an area of activity in which government discretion is the norm; and (2) juxtaposed against the first condition, there must be some enclave of protected individual rights. The problem of unconstitutional conditions arises at the troubled intersection of these two disparate constitutional regimes. Alternatively, when there are two areas with no protected rights, the problem cannot arise. Without some conception of vested rights, there is nothing for the doctrine to protect. That was, I believe, the situation in \textit{Lyng v. International Union, UAW},\textsuperscript{42} given that there is neither a constitutional right to food stamps nor one to collective bargaining. Similarly, the doctrine cannot be applied when too many constitutional rights are inconsistent with each other. That was the case in \textit{Harris v. McRae},\textsuperscript{43} when the right to an abortion and to free exercise of religion were in irreconcilable tension with each other. Applying the doctrine to protect one right (abortion) necessarily infringes on the other right (religion). Likewise, inconsistent rights account for the difficulty in applying the doctrine in \textit{Sherbert v. Verner}\textsuperscript{44} where a free exercise claim is in evident conflict with an opposing establishment argument.

In light of the above analysis, we should see the greatest applica-
tion of the doctrine of unconstitutional conditions when individual rights of speech and religion work at crosstrains with general economic issues. Cases like *Speiser v. Randall*,45 *Bob Jones University v. United States*,46 and *United States v. Lee*47 illustrate the collision course between a relaxed judicial attitude toward economic regulation, in the area of taxation, and a closer level of scrutiny of the regulation of speech and religion. In *Speiser*, the Court held that a real estate tax exemption could not be conditioned upon a willingness to sign loyalty oaths.48 In *Bob Jones*, the Court inexplicably held that government could condition its charitable exemption on the willingness of a religious organization to abide by antidiscrimination laws, even where compliance with the law required people to violate their sincerely held religious beliefs.49 In *Lee*, the Court inexcusably allowed the state to force the Amish to contribute to a social security system from which they refused to collect benefits, even though they regarded participation in the program as a sin.50

Even pure property cases, like *Nollan v. California Coastal Commission*,51 fall into the same category. In *Nollan*, the state's lateral easement, being possessory, was accorded powerful eminent domain protection, while the right to develop privately-owned land was governed by the far less exacting rational basis test under the police power.52 The question that the Court had to face, in this situation, was whether the government could structure its bargains with certain citizens such that it could require individuals to sacrifice an easement to the state in order to obtain the needed building permits. The consequence of the condition is to reduce the gain that the affected property owners receive relative to that which other individuals, not saddled by the same conditions, may obtain.

The five scenarios, set out above, thus apply with equal force to each of these cases. It is only necessary that we make the modest assumption that individuals who are forced to take benefits, subject to unwanted conditions, experience some diminution in their utility, regardless of the nature of the condition (e.g., economic, speech, religious) that is imposed.

These cases are best approached by rules which allow the state to redistribute at will across economic lines, but not across religious, political, or other lines that are subject to higher scrutiny. Therefore, the very treatment of these cases assumes the constitutionality of

45. 357 U.S. 513 (1958), *discussed in* Epstein, *Foreword, supra* note 1, at 75-76.
47. 455 U.S. 252 (1982), *discussed in* Epstein, *Foreword, supra* note 1, at 87-89.
48. 357 U.S. at 529.
49. 461 U.S. at 604.
50. 455 U.S. at 261.
52. 483 U.S. at 834-37.
schemes that would have been struck down under *Lochner*, and, a fortiori, under the analysis of the eminent domain problem that I offered in my *Takings* book. My analysis of unconstitutional conditions still works after the repudiation of *Lochner*, but only so long as some forms of government action are reviewed under a presumption of distrust.

Once there are strong rights of religion and speech, then it follows, as the night the day, that the courts must reject the model of exploitation in talking about contractual and associational rights in these areas. While it may be allowable today for the legislature to conclude that the employer exploits the employee in the labor market, the state cannot ban or regulate political and religious associations on the supposed ground that they systematically exploit their members. Preferred freedoms cannot by stripped away on the carefree assumption that individuals do not know their own interests when they join churches, political parties, or community action groups. Consent has teeth that bite, so we have to address the greater/lesser problem head on — by use of old techniques that were originally developed in the economic area but which still survive and flourish elsewhere. The doctrine of unconstitutional conditions will prove redundant only when all individual rights are subject to the tender mercies of the rational basis test. May that day never come.
