

PUBLIC EMPLOYEES AND THE CURIOUS MINI-REVIVAL OF CONTRACT CLAUSE JURISPRUDENCE

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For decades the Contract Clause of the federal Constitution, once a muscular vehicle for judicial review of state legislation, has languished in the constitutional backwater.¹ The Supreme Court has not invoked the provision in more than 30 years,² although lower federal courts occasionally apply the clause to invalidate state laws.³ Most state constitutions also contain a contract clause, and some state courts enforce the state provision with more vigor than is the current norm in the federal courts.⁴ Since the New Deal era, the Supreme Court has not treated the Contract Clause as a significant barrier to state modification of agreements and rarely hears Contract Clause challenges.⁵

From time to time, however, the Supreme Court has found it necessary to explain that the Contract Clause retains some vitality. In 1977 the Court revealingly observed: “Whether or not the protection

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1. U.S. CONST. art. I, § 10, cl. 1 provides in part: “No State shall . . . pass any . . . Law impairing the obligation of Contracts . . .” For the decline of the Contract Clause, see James W. Ely, Jr., *Whatever Happened to the Contract Clause?*, 4 CHARLESTON L. REV. 371 (2010).

2. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) (retroactive legislative modification of company pension plan ran afoul of Contract Clause); *U.S. Trust Co. v. New Jersey*, 431 U.S. 1 (1977) (state abrogation of bond covenant violated Contract Clause).

3. E.g., *United Healthcare Ins. Co. v. Davis*, 602 F.3d 618 (5th Cir. 2010) (act altering health insurance contracts was substantial impairment of existing contracts and lacked adequate justification); *Equip. Mfrs. Inst. v. Janklow*, 300 F.3d 842 (8th Cir. 2002) (retroactive application of statute limiting termination of dealers by manufacturers not based on legitimate public purpose and was void under Contract Clause).

4. Brian R. Schar, Note, *Contract Clause Law Under State Constitutions: A Model For Heightened Scrutiny*, 1 TEX. REV. L. & POL. 123 (1997).

5. *Keystone Bituminous Coal Ass’n v. DeBenedictis*, 480 U.S. 470, 502 (1987) (declaring that “it is well settled that the prohibition against impairing the obligation of contracts is not to be read literally”).

of contract rights comports with current views of wise public policy, the Contract Clause remains a part of our written Constitution.”⁶ This comment suggests the gap between the views of the framers that contractual stability was essential and contemporary thinking which envisions nearly plenary legislative authority over contracts. Its tone also underscores the Court’s hesitant approach toward enforcement of the Contract Clause. A year later the Court insisted that “the Contract Clause remains part of the Constitution. It is not a dead letter.”⁷ This defensive comment speaks volumes about the lowly position of the Contract Clause in modern constitutional law. Such language, moreover, has not been matched by meaningful enforcement of the provision. Instead, as in other areas of constitutional law,⁸ the Court has formulated a vague multi-prong test for determining Contract Clause violations:

- 1) Has a change in state law operated as a substantial impairment of a contractual obligation? (This inquiry in turn has been subdivided into three components—is there a contract? Has a change in law impaired that contract? Is the impairment substantial?)
- 2) If the impairment is substantial, does the law serve a legitimate public purpose?
- 3) Are the means chosen to accomplish this purpose reasonable and necessary?⁹

6. *U.S. Trust Co.*, 431 U.S. at 16 (1977).

7. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241 (1978).

8. Compare to the multifactor balancing test set forth in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978) to determine the existence of a regulatory taking. See Gideon Kanner, *Making Laws and Sausages: A Quarter-Century Retrospective on Penn Central Transportation Co. v. City of New York*, 13 WM. & MARY BILL RTS. J. 679 (2005); Anthony B. Sanders, *Of All Things Made in America Why Are We Exporting the Penn Central Test?*, 30 NW. J. INT’L L. & BUS. 339, 354 (2010) (observing that under the *Penn Central* approach “courts are free to range just about as widely as they please in determining whether the government has taken property without providing just compensation”).

9. *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411–12 (1983); *U.S. Trust Co.*, 431 U.S. at 17–27 (1977). A number of state courts have also adopted this test in adjudicating state contract clause claims. See, e.g., *Mass. Cmty. Coll. Council v. Commonwealth*, 420 Mass. 126, 649 N.E. 2d 708, 711–13 (1995); *Opinion of the Justices (Furlough)*, 135 N.H. 625, 630, 609 A.2d 1204, 1207 (1992) (finding that federal and state contract clauses “offer equivalent protections where a law impairs a contract”); *Carlstrom v. State*, 103 Wash.2d 1, 694 P.2d 1, 3 (1985) (“[W]e continue to find cases construing the federal provision persuasive in construing the state clause.”).

Each of the prongs of this test warrants comment. On occasion contract clause claims fail because courts either find that no contract existed or rule that there was no legislative impairment of an agreement.¹⁰ For example, in *Scott v. Williams* (2013) the Supreme Court of Florida upheld legislative changes to the state retirement system.¹¹ Faced with a huge budget shortfall, the lawmakers converted the retirement program to a contributory system and ended cost-of-living adjustments for services after July 1, 2011. Although a statute declared that the rights of retirement system members were contractual in nature, the Florida Supreme Court ruled that it did not prevent the legislature from altering benefits which accrue from future service. The Court found no impairment of a contract in violation of the contract clause in the state constitution.

If a court concludes that there was a contractual impairment, they next consider if such infringement was substantial. Whether an impairment is deemed substantial turns in part upon the expectation of the parties. In ascertaining the severity of an impairment, courts give weight to whether the industry had been regulated in the past, taking the position that in such case further regulation might then be expected.¹² Of course, given pervasive regulations in

10. *Gen. Motors Corp. v. Romein*, 503 U.S. 181 (1992) (rejecting argument that workers' compensation law was implied term of collective bargaining agreement, and holding that hence law retroactively imposing additional financial obligations did not violate Contract Clause); *Fraternal Order of Police v. Prince George's Cnty.*, 608 F.3d 183 (4th Cir. 2010) (county reserved limited right to modify its own contract, and hence employee furlough plan did not violate Contract Clause); *Valenti v. Snyder*, 853 F. Supp. 2d 691, 695–96 (E.D. Mich. 2012) (unratified tentative collective bargaining agreement was not a contract entitled to protection under the Contract Clause); *Rhode Island Council 94 v. Rhode Island*, 705 F. Supp. 2d 165 (D. R.I. 2010) (finding that expired collective bargaining agreement did not provide contractual protection for retiree health benefits, and that hence state change in health benefit scheme did not run afoul of Contract Clause); *Barker v. City of Lyon*, 813 N.W. 2d 424, 427–28 (Ct. App. Minn. 2012) (holding that employee's right to post-retirement payment of health insurance premiums has not vested before changes in calculating premiums, and stressing that Contract Clause protects contractual relationships not mere expectation interests); *Alston v. City of Camden*, S.C., 322 S.C. 38, 471 S.E.2d 174 (1996) (holding that neither municipal ordinance nor employee handbook constituted a contract that prevented unilateral reduction in employee benefits by city).

11. *Scott v. Williams*, 107 So. 3d 379, 385–89 (Fla. 2013).

12. *See Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411–16 (1983) (finding that a Kansas price control statute did not substantially impair a contractual arrangement because the parties were operating in a heavily regulated industry and hence the law did not infringe the utility's reasonable expectations); *Toledo Area AFL-CIO Council v. Pizza*, 154 F.3d 307, 324 (6th Cir. 1998) (stressing "existing Supreme Court precedents relying

so many areas of the modern economy, this judicial stress upon the existence of regulation is an avenue to significantly dilute contract clause protection. In deciding whether the challenged law serves a legitimate public purpose, courts consider whether the legislation is aimed at a general problem or benefits special interests. Where a law impairs a private contract, federal courts usually defer to a legislative determination as to whether the measure was reasonable and necessary.¹³

In constructing this analytical framework, the Supreme Court ignored the plain language of the clause, which sets forth an unequivocal command against state impairment of agreements. Not only does finding a contract clause violation rest upon subjective factors and ad hoc inquiry, but in most cases federal courts give substantial deference to legislative assessments. The contemporary approach to the Contract Clause treats state police power as paramount to individual rights under agreements.¹⁴ It is not surprising, then, that with

upon the heavily regulated nature of an industry as grounds to discount the severity of impairments resulting from subsequent regulations”); *Maine Educ. Ass’n Benefits Trust v. Cioppa*, 842 F. Supp. 2d 373 (D. Me. 2012) (stressing heavily regulated nature of insurance industry, and rejecting Contract Clause challenge to legislative changes to insurance regulations on the ground that “parties to those collective bargaining agreements should readily expect that changes in insurance regulations may change the nature of the health insurance benefits as well as the cost of those benefits in coming years”); *Easthampton Savings Bank v. City of Springfield*, 874 F. Supp. 2d 25, 32 (D. Mass. 2012) (noting that mortgage industry has been heavily regulated, and that mortgagee “must have reasonably expected that some of the terms of their mortgages could be impaired by future changes in regulation”); *In re Estate of DeWitt*, 54 P.3d 849, 859 (Colo. 2002) (“Additionally, courts should consider whether the statute in question touches on an area that has historically been regulated by the legislature; if so, the statute is less likely to be found to violate the contract clause.”).

13. *U.S. Trust Co.*, 431 U.S. at 22–23 (1977) (“As is customary in reviewing economic and social regulation . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.”); *Easthampton Sav. Bank v. City of Springfield*, 874 F. Supp. 2d 25, 32 (D. Mass. 2012) (stressing deference to legislative judgment and finding that mortgage foreclosure ordinance protected basic societal interest); *In re Estate of DeWitt*, 54 P.3d at 859 (Colo. 2002) (“When the state is not a party to the contract, a court should defer to the legislature’s judgment regarding the necessity and reasonableness of the statute, notwithstanding that the statute may impose a financial hardship on the contracting parties.”).

14. *U.S. Trust Co.*, 431 U.S. at 22 (1977) (“The States must possess broad power to adopt general regulatory measures without being concerned that private contracts will be impaired, or even destroyed, as a result.”); *Toledo Area AFL-CIO Council v. Pizza*, 154 F.3d 307, 322 (6th Cir. 1998) (“Contract Clause jurisprudence evinces a concern for ensuring that the regulatory power of the States is not eviscerated by a per se ban on legislation impairing private contracts.”).

respect to private contracts the Contract Clause has been drained of much meaning.¹⁵

The situation, however, is somewhat different regarding contracts to which a state is a party. Maintaining that a state's self-interest is involved when a state impairs its own agreements, the Supreme Court in *U.S. Trust Co. v. New Jersey* (1977) declared that in this context "complete deference to a legislative assessment of reasonableness and necessity is not appropriate."¹⁶ It explained that if "a State could reduce its financial obligation whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all."¹⁷ In determining the necessity for a state to abrogate its own obligations, the Court insisted that "a State is not completely free to consider impairing the obligation of its own contracts on a par with other policy alternatives."¹⁸ It then found that the retroactive repeal of a bond covenant pledging revenue as security for the bonds was neither reasonable nor necessary.¹⁹ Although state courts are not obligated

15. This result parallels the current federal judicial treatment of other property clauses in the Constitution and Bill of Rights. Challenges to economic regulations based upon the due process clauses of the Fifth and Fourteenth clauses are reviewed under a toothless rational basis test and such regulations are presumed to be constitutional. As a practical matter, due process challenges to economic regulations never prevail. JAMES W. ELY, JR., *THE GUARDIAN OF EVERY OTHER RIGHT: A CONSTITUTIONAL HISTORY OF PROPERTY RIGHTS* 139–41, 149–50 (3rd ed. 2008). Revealingly, the Second Circuit Court of Appeals has explicitly endorsed a rational basis test to determine whether an impairment of private contracts violates the Contract Clause. *Ass'n of Surrogates & Sup. Ct. Reporters v. New York*, 940 F.2d 766, 771 (2d Cir. 1991), *cert. denied*, 502 U.S. 1058 (1992). Similarly, the Fifth Amendment's "public use" limitation on the exercise of eminent domain at the federal level has been virtually eviscerated by heavy deference to legislative determinations of what constitutes public use. *E.g.*, *Kelo v. City of New London*, 545 U.S. 469 (2005).

16. 431 U.S. 1, 26 (1977).

17. *Id.* at 26.

18. *Id.* at 30–31.

19. Justice William J. Brennan dissented in an opinion stressing state power over public contracts. He observed:

Decisions of this Court for at least a century have construed the Contract Clause largely to be powerless in binding a State to contracts limiting the authority of successor legislatures to enact laws in furtherance of the health, safety, and similar collective interests of the polity. In short, those decisions established the principle that lawful exercise of a State's police power stand paramount to private rights held under contract.

Id. at 33. Brennan specifically rejected the majority's holding that stricter judicial review is appropriate when a state impairs its own obligations. *Id.* at 53, n.16.

to adopt the double standard of review in construing the contract clauses in state constitutions, many have followed suit.²⁰ “Because a governmental entity is party to the contract and benefits from the impairment,” the Court of Appeals of Michigan remarked, “we are to employ heightened scrutiny in our review of the statute.”²¹

The lowered deference standard applied when a state has altered its own contractual obligations has raised a related issue concerning allocation of the burden of proof. Some courts have placed the burden of proving the reasonableness and necessity of the impairment on the state.²² In 2011, however, the First Circuit Court of Appeals allocated the burden of proof to the parties challenging the state’s actions.²³ The court was concerned that requiring the state to prove reasonableness and necessity “would likely discourage legislative action impacting public contracts” and declared that even in the context of public contracts “the state’s judgment that the impairment was justified is afforded meaningful deference.”²⁴

I. PUBLIC AGREEMENTS AND THE CONTRACT CLAUSE

The dual standard of review adopted in *U.S. Trust Co.* represented a radical departure from prior contract clause jurisprudence. To appreciate this point we should briefly sketch the history of the Contract Clause pertaining to public agreements. Historians have long debated the intended scope of the provision.²⁵ Although the Contract Clause received surprisingly little discussion at the constitutional convention and the state ratifying conventions, all agree that the framers were vitally concerned about safeguarding private agreements from state impairment. The immediate impetus for the provision was the need to curb state debtor relief measures which

20. See, e.g., *Valdes v. Cory*, 139 Cal. App. 3d 773, 790, 189 Cal. Rptr. 3d 212, 226 (1983).

21. *AFT Michigan v. State*, 297 Mich. App. 597, 825 N.W.2d 595, 602 (Mich. App. 2012), application for leave to appeal pending.

22. See, e.g., *Toledo Area AFL-CIO Council v. Pizza*, 154 F.3d 307, 323 (6th Cir. 1998).

23. *United Auto., Aerospace, Agric. Implement Workers v. Fortuno*, 633 F.3d 37, 42–45 (1st Cir. 2011).

24. *Id.* at 43–44.

25. James W. Ely, Jr., *The Marshall Court and Property Rights: A Reappraisal*, 33 J. MARSHALL L. REV. 1023, 1029–33 (2000) (reviewing the literature discussing the scope of the Contract Clause and concluding that the framers envisioned a broad reading of the provision to cover all types of contractual rights).

undercut the sanctity of private agreements and threatened to disrupt credit relationships. One cannot, however, infer the scope of the clause solely from the necessities of the moment. Unlike a similar provision in the Northwest Ordinance which is expressly limited to private contracts, the Contract Clause is phrased in broad and unqualified language and would seemingly reach all types of agreements. As Wallace Mendelson cogently pointed out, “[i]f the Constitutional Convention had wanted the clause to cover only private contracts, it could easily have said so.”²⁶ It is far from evident that the framers intended to differentiate between public and private contracts. Indeed, after ratification two prominent framers, James Wilson,²⁷ then a member of the Supreme Court, and Alexander Hamilton,²⁸ expressed the view that states were bound by their contractual undertakings.

Federal courts early took the position that state contracts were within the ambit of the Contract Clause. In *Vanhorne’s Lessee v. Dorrance* (1795) Justice William Paterson, a member of the constitutional convention and later a member of the Supreme Court, treated a state land grant as a contract and declared that a state could not abrogate a prior disposition of land in violation of the Contract Clause.²⁹ Likewise, in *Fletcher v. Peck* (1810) the first Supreme Court decision to address the Contract Clause, Chief Justice John Marshall ruled that a state land grant was an executed contract protected by the Contract Clause, and that the clause prevented states from abrogating such grants.³⁰ In a famous line of decisions, the Supreme Court thereafter construed the Contract Clause to bar state infringement of grants of tax exemptions and corporate charters.³¹ Despite some criticism of these decisions starting in the late nineteenth century,³² the

26. Wallace Mendelson, *B. F. Wright on the Contract Clause: A Progressive Misreading of the Marshall-Taney Era*, 38 W. POL. Q. 262 (1985).

27. *Chisholm v. Georgia*, 2 U.S. 419, 465 (1793) (Wilson, J.).

28. 4 THE LAW PRACTICE OF ALEXANDER HAMILTON 382–84 (Julius Goebel, Jr. & Joseph H. Smith, eds., 1980).

29. 2 U.S. 304 (Cir. Ct. Penn. 1795).

30. 10 U.S. 87 (1810).

31. *Dartmouth Coll. v. Woodward*, 17 U.S. 518 (1819); *Wilson v. New Jersey*, 11 U.S. 164 (1812).

32. In the 1870s some commentators sought to reopen the question of whether the Contract Clause reached public contracts. Their particular target was *Dartmouth College*, which was seen as a shield for corporate privilege. In the 1871 edition of his influential treatise, *TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES* 280 n.2 (2nd ed. 1871), Thomas M. Cooley sharply criticized *Dartmouth College* and the public

principle that the Contract Clause covered public contracts seemed well settled. “To allow a state to repudiate its contracts unilaterally,” Richard A. Epstein has cogently observed, “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 group at the expense of others.”³³

Yet courts gradually developed doctrines that curtailed the protection afforded public contracts. In *Charles River Bridge v. Warren Bridge* (1837), for example, the Supreme Court determined that corporate charters should be strictly construed for Contract Clause purposes, and that only express privileges were to be safeguarded from legislative alteration.³⁴ In *West River Bridge Co. v. Dix* (1848) the Court held that a state’s exercise of eminent domain prevailed over any rights conferred by corporate charters.³⁵ All contracts, including franchise privileges, were subordinated to that power. More significant was a line of decisions, beginning in the 1870s, declaring that the states could not bargain away their police power to safeguard the health, safety, and morals of the public.³⁶ The Contract Clause makes no mention of a police power exception, and in fact appears to impose an absolute bar on state impairments. As the notion of police power was enlarged in the twentieth century, the Contract Clause, especially with respect to public arrangements, would be reduced in importance.

Although the Supreme Court gradually allowed the states latitude to modify or abridge public contracts, it continued to vigorously police the infringement of private agreements. It looked skeptically at state laws hampering the foreclosure of mortgages and the collection of debts. In *Bronson v. Kinzie* (1843) the Court struck down laws that retroactively altered the terms of existing mortgages.³⁷ Chief Justice Roger B. Taney asserted that the purpose of the Contract

law branch of contract clause jurisprudence. See generally HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836–1937 19–35 (1991) (noting that conception of a corporate charter as a contract “fell apart” in late nineteenth century).

33. Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 41 U. CHI. L. REV. 703, 719 (1984).

34. 36 U.S. 420 (1837).

35. 47 U.S. 507 (1848).

36. *Stone v. Mississippi*, 101 U.S. 814 (1880); *Fertilizing Co. v. Hyde Park*, 97 U.S. 659 (1878); *Beer Co. v. Massachusetts*, 97 U.S. 25 (1878).

37. *Bronson v. Kinzie*, 42 U.S. 311 (1843).

Clause “was to maintain the integrity of contracts, and to secure their faithful execution throughout this Union.”³⁸ Similarly, the Court invalidated the retroactive application of homestead exemption laws to pre-existing contracts.³⁹ In *Barnitz v. Beverly* (1896) the justices struck down a Kansas law authorizing the redemption of foreclosed property where no such right previously existed.⁴⁰ State courts also frequently invalidated debt-relief measures that retroactively infringed private contract rights.⁴¹

To be sure, in the early twentieth century the Supreme Court began to gradually weaken the protection of private obligations under the Contract Clause. In 1905, without much discussion, the Court extended the police power exception to private agreements between individuals. It declared that “parties may not estop the legislature from enacting laws intended for the public good.”⁴² Protection of private agreements was further diluted when the Supreme Court, sustaining rent controls growing out of World War I, ruled that state authority to deal with emergencies was paramount to private contracts.⁴³

The Contract Clause then received an even more grievous blow in *Home Building & Loan Association v. Blaisdell* (1934), a decision that became the cornerstone of the modern reading of the provision.⁴⁴ This ruling by a sharply divided Supreme Court upheld a two-year state moratorium on the foreclosure of mortgages. The measure was reminiscent of debt-relief laws that federal and state courts had repeatedly struck down in the nineteenth century. Chief Justice Charles Evans Hughes, speaking for the majority, stressed that the moratorium was a temporary response to the economic emergency created by the Great Depression. In effect, he enlarged the police power to

38. *Id.* at 318.

39. *Edwards v. Kearzey*, 96 U.S. 595 (1878); *Gunn v. Barry*, 82 U.S. 610 (1873). For contract clause challenges to retroactive application of enlarged homestead exemptions, see James W. Ely, Jr., *Homestead Exemption and Southern Legal Culture*, in *SIGNPOSTS: NEW DIRECTIONS IN SOUTHERN LEGAL HISTORY* 295–302 (Sally E. Hadden & Patricia Hagler Minter, eds., 2013).

40. 163 U. S. 118 (1896) (Shiras, J.).

41. *See, e.g.*, *Sheets v. Peabody*, 7 Blackf. 613 (Ind. 1846); *Rosier v. Hall*, 10 Iowa 470 (1860); *Jones v. Crittenden*, 4 N.C. 55 (1814); *Hollister v. Donahoe*, 78 N.W. 959 (S.D. 1899).

42. *Manigault v. Springs*, 199 U.S. 473, 480 (1905).

43. *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170, 198 (1921).

44. 290 U.S. 398 (1934). For the background of this case, see JOHN A. FLITER & DEREK S. HOFF, *FIGHTING FORECLOSURE: THE BLAISDELL CASE, THE CONTRACT CLAUSE, AND THE GREAT DEPRESSION* (2012).

encompass the regulation of economic conditions. The controversial *Blaisdell* case is the subject of a vast literature and cannot be treated in detail here.⁴⁵ As a practical matter, *Blaisdell* drained the Contract Clause of much vitality and opened the door for legislation that weakened the security of private agreements. In dissent, Justice George Sutherland presciently warned of “future gradual but ever-advancing encroachments upon the sanctity of private and public contracts.”⁴⁶ Indeed, as the New Deal justices gained ascendancy on the Court, they stressed deference to legislative judgments and abandoned any notion that emergency conditions were necessary to vindicate state interference with contracts. Consequently, the Contract Clause as presently construed seems to prohibit very little. The key point for our purpose is that historically the Supreme Court treated public and private contracts on more or less a level playing field, and certainly did not accord public contracts a special degree of solicitude.

This historical pattern was altered, of course, when the Supreme Court in *U.S. Trust Co.* turned away from a unitary standard of review and provided more stringent review when a state impaired its own obligations. It is apparent that there are serious problems with this dual standard. First, there is no textual or historical basis for differentiating between the scrutiny accorded to private and public contracts, nor was that the practice throughout the nineteenth century. Indeed, courts historically were more alert to police violations of private agreements, and were more deferential to state authority over public contracts.⁴⁷ From an historical perspective, therefore, *U.S.*

45. For criticism of *Blaisdell*, see Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 735–38 (1987); Douglas W. Kmiec & John O. McGinnis, *The Contract Clause: A Return to the Original Understanding*, 14 HASTINGS CONST. L.Q. 525, 541–44 (1987); Rebecca M. Kahan, Comment, *Constitutional Stretch, Snap-Back, & Sag: Why Blaisdell Was A Harsher Blow to Liberty Than Korematsu*, 99 NW. U. L. REV. 1279, 1302–07 (2005); Charles A. Bieneman, Note, *Legal Interpretation and a Constitutional Case: Home Building & Loan Association v. Blaisdell*, 90 MICH. L. REV. 2534, 2535–64 (1992) (arguing that *Blaisdell* “was wrongly decided under any theory of interpretation”). See also ROBERT A. LEVY & WILLIAM MELLOR, *THE DIRTY DOZEN: HOW TWELVE SUPREME COURT CASES RADICALLY EXPANDED GOVERNMENT AND ERODED FREEDOM* 50–66 (2008) (criticizing *Blaisdell* as one of the most harmful Supreme Court decisions since the New Deal).

46. *Blaisdell*, 290 U.S. at 448 (Sutherland, J., dissenting).

47. Kmiec & McGinnis, *supra* note 45, at 547 (“The state invokes the same justification for modifying public contracts and private contracts—namely, that public welfare will be advanced by the alteration—and the alteration should be reviewed under the same standard”); Michael W. McConnell, *Contract Rights and Property Rights: A Case Study in the Relationship Between Individual Liberties and Constitutional Structure*, 76 CAL. L. REV. 267, 293–94 (1988)

Trust Co. has things backwards. Courts allowed state lawmakers greater latitude regarding changes in state contracts. Second, the Court has failed to offer a clear explanation for this dual standard of review. cursory references to a state's self-interest are not compelling. The self-interest of legislators could also be at issue when they interfere with contracts between private parties. "All legislative decisions," one scholar has pointed out, "presumably involve the state's self-interest."⁴⁸ Third, and equally troublesome, the Court has never explained what level of deference is applicable to state actions concerning public contracts, and the lower federal courts have been left to wrestle with this issue without guidance. Consequently, the notion of less deference has done more to obscure than to enlighten.

II. THE DEBT CRISIS AND PUBLIC EMPLOYEE CONTRACTS

Whatever the wisdom of a heightened standard of review for public contracts, the notion that state infringement of their obligations should receive a less deferential level of scrutiny features prominently in contract clause attacks upon state and local government efforts to modify public employee contracts. In recent years states and localities have suffered recurring periods of grave fiscal crisis, marked by huge budget shortfalls and underfunded pension plans.⁴⁹

("[T]he modern thrust of contracts clause jurisprudence is precisely backwards. . . . It is interference with private contracts that lies at the heart of the clause."); Thomas W. Merrill, *Public Contracts, Private Contracts, and the Transformation of the Constitutional Order*, 37 CASE WESTERN L. REV. 597, 609 (1987) ("[T]he modern Court has in effect turned the contract clause of both the framers and the post-*Charles River Bridge* era on its head. The prior understanding was that private contracts were protected from state interference with *more* rigor than public contracts."). See also *U.S. Trust Co.*, 431 U.S. at 53 n.16 (1977) (Brennan, J., dissenting) (finding no historical support for applying a stricter standard when a state's own obligations are at issue).

48. Stewart E. Sterk, *The Continuity of Legislatures: Of Contracts and the Contract Clause*, 88 COLUM. L. REV. 647, 687 (1988).

49. RICHARD RAVITCH & PAUL A. VOLCKER, REPORT OF STATE BUDGET CRISIS TASK FORCE (July 17, 2012) (surveying six states, stressing huge underfunding of pension and health care liabilities for retired public employees, and noting volatility of state revenues). The severe shortfall in state pension plan funding can be traced to several sources. See Debra Brubaker Burns, *Too Big to Fail and Too Big to Pay: States, Their Public-Pension Bills, and the Constitution*, 39 HASTINGS CONST. L. Q. 253, 267 (2011-2012) ("First, many states over-promised benefits to employees during the financially flush 1990s. Second, many states have projected unrealistic amounts of funding resources or rates of return for current and future pension investments.").

In January of 2013, for instance, bond-rating agencies downgraded Illinois bonds to the lowest rating in the United States, citing massive unfunded pension liabilities and the lack of any legislative action to address the problem.⁵⁰ As one authority has explained, “perhaps the single largest problem facing municipalities today is the dramatic and growing shortfall in public pension funds.”⁵¹ Facing severe financial pressure, many municipalities are on the brink of insolvency. For example, several municipalities in California have filed for bankruptcy.⁵² Within the context of bankruptcy a local government may gain the flexibility to cancel or alter contracts that could not otherwise be terminated. In June of 2013 the City of Detroit filed for bankruptcy, the largest municipal bankruptcy in American history. City officials maintain that generous retirement and health care benefits are an unsustainable burden for an impoverished community with a sizeable debt

See also Ernest A. Young, *Its Hour Come Round At Last? State Sovereign Immunity and the Great State Debt Crisis of the Early Twenty-First Century*, 35 HARV. J.L. & PUB. POL’Y 593, 617–20 (2012) (discussing the severe debt crisis in several states, and pointing out that “states have failed to set aside money to fund future obligations for healthcare costs and pensions”); Gavin Reinke, Note, *When a Promise Isn’t a Promise: Public Employers’ Ability to Alter Pension Plans of Retired Employees*, 64 VAND. L. REV. 1673, 1679 (2011) (“This mismanagement and lack of foresight combined to produce significant shortfalls for state public employee pension funds in a very short period.”).

50. Mark Peters, *S&P Cuts Illinois Credit Rating*, WALL ST. J. (Jan. 25, 2013, 5:30 PM), <http://online.wsj.com/article/SB10001424127887324539304578264293106044944.html#articleTabs%3Darticle>. The Illinois legislature remains deadlocked over steps to deal with the pension crisis. Mark Peters, *Pension Deal Again Proves Elusive in Illinois*, WALL ST. J., June 3, 2013.

51. Jeffrey B. Ellman & Daniel J. Merrett, *Pensions and Chapter 9: Can Municipalities Use Bankruptcy to Solve Their Pension Woes?*, 27 EMORY BANKR. DEV. J. 365, 367 (2012). *See also* THE PEW CTR. ON THE STATES, *THE WIDENING GAP UPDATE* 1–11 (June 2012) (pointing out that despite widespread steps to reduce the cost of retiree benefits the gap between state assets and obligations for public sector employee benefits has actually increased).

52. In the 1930s Congress provided for municipality bankruptcy in response to the impact of the Great Depression on local governments. The law was substantially revised in the mid-1970s in the wake of New York City’s financial crisis. For the current statute, enacted in 1978, see 11 U.S.C. §§ 901–946 (2013). Chapter 9, providing federal bankruptcy relief for municipalities, has been rarely used in the past. Pursuant to the Supreme Court’s decision in *United States v. Bekins*, 304 U.S. 27 (1938), a Chapter 9 filing by a municipality must be authorized by the state. Accordingly, the availability of municipal bankruptcy relief varies widely among the states. Richard A. Trotter, *Running on Empty: Municipal Insolvency and Rejection of Collective Bargaining Agreements in Chapter 9 Bankruptcy*, 36 S. ILL. U. L.J. 45, 55–56 (2012). Bankruptcy is not available for the states, although there have been proposals for a bankruptcy law that would allow states to restructure unsustainable debts. *See* David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677 (2012) (arguing that Congress should fashion a bankruptcy option for states facing financial collapse).

and a declining population. The Michigan Constitution protects the pension system of public employees from being diminished. The extent to which, if at all, Detroit pensions should be restructured in bankruptcy is hotly contested.⁵³ Moreover, a number of other financially distressed Michigan cities are operating under state-appointed emergency managers.

In this climate many state and local governments have begun to reconsider and trim benefits for public sector employees.⁵⁴ Such steps have taken various forms—reducing pensions for current workers as well as retirees, raising the retirement age, setting new eligibility requirements, increasing worker contributions to pension and health plans, imposing wage freezes, mandatory unpaid furloughs and payroll lags, and modifying both cost-of-living adjustments and the caps on earnings for retirees. These measures often infringe collective bargaining agreements. Others may run afoul of state constitutional or statutory provisions recognizing state employee retirement systems as some form of a contractual relationship. In 1938 New York became the first state to adopt such a provision in its constitution.⁵⁵ Six other states followed suit, although the extent of the constitutional protection afforded employee benefit schemes varies.⁵⁶ The Illinois Constitution, for example, not only declares that membership in a public retirement system amounts to a contract but broadly states “[t]he accrued benefits of members of any state or statewide public retirement system shall not be diminished or impaired.”⁵⁷ A more difficult

53. David Skeel, *Facing Up to America's Pension Woes*, WALL ST. J., July 25, 2013.

54. Stephen F. Befort, *Unilateral Alteration of Public Sector Collective Bargaining Agreements and the Contract Clause*, 59 BUFF. L. REV. 1, 8–12 (2011); Paul M Secunda, *Constitutional Contracts Clause Challenges in Public Pension Litigation*, 28 HOFSTRA LAB. & EMP. L.J. 263 (2010). See also Eric M. Madiar, *Public Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants?*, 27 A.B.A. J. LAB. & EMP. L. 179, 180–85 (2012) (discussing moves to reduce state employee retirement benefits, and surveying different legal approaches in how states treat pension plans).

55. N.Y. Const. art. V, § 7.

56. Besides New York, Alaska, Arizona, Hawaii, Illinois, Louisiana, and Michigan have constitutional provisions pertaining to public employee pensions. Florida, Kentucky and Wisconsin have statutes declaring that participation in a state retirement system constitutes a contract. Kenneth T. Cuccinelli II, E. Duncan Getchell, Jr., & Wesley G. Russell, Jr., *Judicial Compulsion and the Public Fisc—A Historical Overview*, 35 HARV. J. L. & PUB. POL'Y 525, 535–36 (2012); Ellman & Merrett, *supra* note 51, at 378 (2012); Anna K. Selby, Comment, *Pensions in a Pinch: Why Texas Should Reconsider Its Policies on Public Retirement Benefit Protection*, 43 TEX. TECH. L. REV. 1211, 1231–34 (2011).

57. Ill. Const. art. XIII, § 5. The pension clause of the Illinois Constitution could pose a more formidable barrier to benefit reform than the Contract Clause. Eric Michael Madiar, *Is*

question is presented where there is no express agreement or constitutional provision. Under those circumstances a claimant must first establish that a particular statute gives rise to a contractual relationship, not a mere expectancy. Courts presume that legislation usually sets a policy which may be changed as circumstances dictate.⁵⁸ They require an unequivocal expression of legislative intent to create a binding contract.⁵⁹ Notwithstanding this presumption against construing statutes as contracts, courts in a majority of states take the position that employee participation in a governmental retirement system creates a contract between the state and its employees.⁶⁰ Thus, efforts to

Welching on Public Pension Promises an Option for Illinois? An Analysis of Article XIII, Section 5 of the Illinois Constitution, 1–76 (March 1, 2011), <http://ssrn.com/abstract=1774163>. However, there is authority that health insurance benefits for state employees and retirees are not covered by the pension protection clause of the Illinois Constitution. *Maag v. Quinn*, No. 2012 L 162 (Ill. 7th Jud. Cir. Mar. 19, 2013) (order granting motions to dismiss).

58. *Dodge v. Bd. of Educ.*, 302 U.S. 74, 79 (1937) (“The presumption is that such a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise. He who asserts the creation of a contract with the state in such a case has the burden of overcoming the presumption.”).

59. *Nat’l R.R. Passenger Corp. v. Atchison, Topeka, & Santa Fe R.R. Co.*, 470 U.S. 451, 465–66 (1985) (“Policies, unlike contracts, are inherently subject to revision and repeal, and to construe laws as contracts when the obligation is not clearly expressed would be to limit drastically the essential powers of a legislative body.”). *See also* *Maag v. Quinn*, No. 2012 L 162, slip op. 1, 5 (Ill. 7th Cir. Ct. Mar. 19, 2013) (observing that “[e]mployees cannot turn employment benefits conferred by statute into enforceable contract rights by continuing their employment, nor can implementing agencies convert statutes into contracts,” and holding that Illinois statutes did not create enforceable contract rights in retirees for health care benefits); *Strunk v. Pub. Emp. Retirement Bd.*, 338 Or. 145, 108 P.3d 1058, 1075 (2005); *Tice v. State*, No. 10-225, slip op. at 12 (S.D. 6th Cir. Ct. April 11, 2012) (finding that state employee “does not have a contract right to a forever COLA at the rate which was in effect at the time of Plaintiff’s retirement”).

60. *See, e.g., Valdes v. Cory*, 139 Cal. App. 3d 773, 783, 189 Cal. Rptr. 3d 212, 221 (1983); *Justus v. State*, 2012 WL 4829545 (Colo. Ct. App. 2012), *petition for cert.* to Colorado Supreme Court pending (holding that retired public employees have contractual right to cost-of-living adjustment formula in effect at time of retirement, but remanding case to determine whether modification of COLA was substantial impairment of contract and was reasonable and necessary to serve a public purpose); *Unified Gov’t of Athens-Clarke Cnty. v. McCrary*, 280 Ga. 901, 635 S.E.2d 150, 151 (2006); *Denning v. Kansas Pub. Emp. Retirement Sys.*, 285 Kan. 1045, 180 P.3d 564, 569 (2008); *Cloutier v. State*, 163 N.H. 445, 452–58, 42 A.3d 816, 821–26 (2012) (holding that retirement plan for judges created contract subject to age and service requirements, but remanding case to ascertain whether change in calculation of retirement benefits amounted to substantial impairment of contract); *Oregon Police Officers’ Ass’n v. State*, 323 Or. 356, 918 P.2d 765, 775–76 (1996). *See also* Eric M. Madiar, *Public Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants?*, 27 A.B.A. J. LAB & EMP. L. 179, 181 (2012) (“Most states follow the contractual approach based on court decisions or specific constitutional or statutory decisions.”).

Only a few jurisdictions adhere to the once dominant view that the retirement benefits of public employees are merely expectancies which can be altered without restriction. *See* Pennie

modify health and pension benefits set the stage for litigation alleging a violation of the Contract Clause.⁶¹

Given the malleable nature of the applicable test and the uncertainty over the standard of review, it is hardly surprising that federal and state courts have reached conflicting decisions regarding state legislation that curtailed the existing contractual rights of public employees. One line of cases found no contract clause violation and sustained the moves by state and local governments to unilaterally alter labor contracts.⁶² Although recognizing that more stringent oversight is required when a state impairs its own contracts, these courts insist that some deference to legislative policy decisions is nonetheless warranted.⁶³ They also typically give great weight to the severity of the budgetary problems confronting lawmakers. Thus, in 2011 the First Circuit Court of Appeals stressed that “in today’s fiscal climate . . . many states face daunting budget deficits that may necessitate decisive and dramatic action.”⁶⁴ In assessing the reasonableness and

v. Reis, 132 U.S. 464, 471 (1889); *Dallas v. Trammell*, 129 Tex. 150, 156, 101 S.W.2d 1009, 1016–17 (1937). The existence of a contract, of course, is a prerequisite to sheltering employee benefits under the Contract Clause.

61. There is little doubt that states have a largely free hand to alter benefits prospectively for newly hired employees because the Contract Clause only protects existing contracts against retroactive impairment. “With the exception of layoffs and furloughs,” one authority has pointed out, “a state’s tools for addressing unsustainable contracts with its public employee unions ordinarily apply only to future contracts.” David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 711 (2012). Such future changes, however, do little to alleviate a state’s current liabilities.

62. *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362 (2d Cir. 2006), *cert. denied*, 550 U.S. 918 (2007); *Baltimore Teachers Union v. Major & City Council of Baltimore*, 6 F.3d 1012 (4th Cir. 1993), *cert. denied*, 510 U.S. 1141 (1994); *United Auto., Aerospace, Agric. Implement Workers v. Fortuno*, 633 F.3d 37 (1st Cir. 2011); *In the Matter of Subway-Surface Supervisors Ass’n v. New York City Transit Auth.*, 44 N.Y.2d 101, 375 N.E.2d 384 (1978) (finding that imposition of wage freeze did not violate Contract Clause).

63. *United Auto., Aerospace, Agric. Implement Workers v. Fortuno*, 633 F.3d 37, 44–45 (1st Cir. 2011); *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 370 (2d Cir. 2006), *cert. denied*, 550 U.S. 918 (2007) (“[B]ut what does giving less deference to the legislature actually mean? We hasten to point out that less deference does not imply no deference.”); *Baltimore Teachers Union v. Major & City Council of Baltimore*, 6 F.3d 1012, 1019 (4th Cir. 1993), *cert. denied*, 510 U.S. 1141 (1994) (“While complete deference is inappropriate, however, at least some deference to legislative policy decisions to modify these contracts in the public interest must be accorded.”). *See also* Cuccinelli, Getchell, & Russell, *supra* note 55, at 541 (“Changes in these situations could be sustained upon a showing of financial necessity to preserve the program at all. Refusal by the courts to accord some deference to a legislative finding of necessity would be problematic.”).

64. *United Auto., Aerospace, Agric. Implement Workers v. Fortuno*, 633 F.3d 37, 43 (1st Cir. 2011). *See also* *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 363, 373 (2d Cir. 2006), *cert.*

necessity of the challenged measures, these courts pointedly refuse to act, in the words of the Fourth Circuit Court of Appeals, “as super-legislatures,” and decline to second-guess policy alternatives. As the Fourth Circuit explained: “Not only are we ill-equipped even to consider the evidence that would be relevant to such conflicting policy alternatives; we have no objective standards against which to assess the merit of the multitude of alternatives.”⁶⁵ In the same vein, the Second Circuit, upholding a City of Buffalo temporary wage freeze, even raised the scarecrow of a return to *Lochner* if courts could evaluate whether other alternatives might have been better to address the city’s bleak financial picture.⁶⁶

Illustrative of this trend is a 2008 decision by the Supreme Court of Kansas rejecting a contract clause challenge to change in retirement benefits. The court declared that reasonable alteration of an employee’s pension rights to protect the financial integrity of the system could be sustained so long as the change balances the benefits and detriments to employees. It observed that “our precedent has recognized that there may be times when pension system changes are necessary for the greater good, even if an individual employee or retirant may suffer some marginal disadvantage.”⁶⁷

Other courts have looked more skeptically at state laws that cut public employee benefits, reasoning that such actions ran afoul of the Contract Clause.⁶⁸ These courts gave less weight to the existence

denied, 550 U.S. 918 (2007) (“[N]o one questions the existence of a very real fiscal emergency in Buffalo.”); *In the Matter of Subway-Surface Supervisors Ass’n v. New York Transit Auth.*, 44 N.Y.2d 101, 375 N.E.2d 384, 389 (1978) (noting “the financial distress under which the city was laboring and which threatened to overwhelm it”).

65. *Baltimore Teachers Union v. Mayor of Baltimore*, 6 F.3d 1012, 1022 (4th Cir. 1993), *cert. denied*, 510 U.S. 1141 (1994).

66. *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 371 (2d Cir. 2006), *cert. denied*, 550 U.S. 918 (2007). For decades the Supreme Court’s decision in *Lochner v. New York*, 198 U.S. 45 (1905) has been assailed as a poster child of judicial activism in support of business interests, and has served as a punching bag for constitutional theorists of various stripes. Recently, a number of revisionist scholars have defended the decision as a vindication of individual liberty, and attacked the conventional account of the case as inaccurate and politically inspired. See DAVID E. BERNSTEIN, *REHABILITATING LOCHNER: DEFENDING INDIVIDUAL RIGHTS AGAINST PROGRESSIVE REFORM* (2011).

67. *Denning v. Kansas Pub. Emp. Retirement Sys.*, 285 Kan. 1045, 180 P.3d 564, 570 (2008).

68. *Univ. of Hawaii Prof’l Assembly v. Cayetano*, 183 F.3d 1096 (9th Cir. 1999); *Ass’n of Surrogates & Sup. Ct. Reporters v. State of New York*, 940 F.2d 766 (2d Cir. 1991), *cert. denied*, 502 U.S. 1058 (1992); *State of Nevada Emp. Ass’n, Inc. v. Keating*, 903 F.2d 1223 (9th Cir. 1990); *Chiles v. United Faculty of Florida*, 615 So.2d 671 (Fla. 1993) (holding that legislature’s

of a fiscal crisis, and some even pointed out that financial problems were foreseeable when collective bargaining agreements were made.⁶⁹ They questioned whether, on the facts presented in particular situations, infringement of labor contracts served a public purpose.

The difficulty with this inquiry into public purpose is well illustrated in *American Federation of State, County and Municipal Employees v. City of Benton* (2008).⁷⁰ The city announced plans to terminate the payment of retiree health insurance premiums. Finding that the city's unilateral action amounted to a substantial impairment of a collective bargaining agreement, the Eighth Circuit Court of Appeals turned to consider whether the city had a legitimate public purpose to justify its plan. The court was skeptical about the city's argument grounded on financial necessity. "Although economic concerns can give rise to the City's legitimate use of the police power," the court explained, "such concerns must be related to 'unprecedented emergencies,' such as mass foreclosures caused by the

unilateral abrogation of pay raise in collective bargaining agreement violated contract clause in Florida Constitution); *Massachusetts Cmty. Coll. Council v. Commonwealth*, 420 Mass. 126, 649 N.E.2d 126 (1995) (unpaid furloughs impaired collective bargaining agreement); *AFT Michigan v. State*, 297 Mich. App. 597, 825 N.W.2d 595, 600–04 (Mich. App. 2012), *application for leave to appeal pending* (state law requiring school districts to withhold three percent of employee wages as contribution to fund for retiree health care benefits violated contract clause in both federal and state constitutions); *Opinion of the Justices (Furlough)*, 135 N.H. 625, 609 A.2d 1204 (1992); *Oregon Police Officers' Ass'n v. State*, 323 Or. 356, 918 P.2d 765 (1996) (statute increasing level of employee contributions to state pension plan runs afoul of federal Contract Clause); *Carlstrom v. State*, 103 Wash.2d 391, 694 P.2d 1 (1985) (legislative cancellation of salary increase provided for in union agreement was unconstitutional impairment of contract). *See also* *Donohue v. Paterson*, 715 F. Supp. 2d 303 (N.D.N.Y. 2010) (on motion for preliminary injunction, emergency appropriation bill which imposed unpaid furloughs and wage freeze held to constitute likely violation of Contract Clause); *Welch v. Brown*, 2013 WL 1292373 (E. D. Mich. 2013) (finding that action by city to alter retiree health care plans under collective bargaining agreement likely violated contract clause, and granting temporary injunction against modification of contract).

69. *Univ. of Hawaii Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1107 (9th Cir. 1999) (declaring that state "knew of the budgetary crisis at the time the collective bargaining agreement was negotiated," and the impairment was therefore not reasonable); *Massachusetts Cmty. Coll. Council v. Commonwealth*, 420 Mass. 126, 649 N.E.2d 708, 716 (1995) (noting that state's fiscal problems "were reasonably foreseeable when the collective bargaining agreements were signed"); *Strunk v. Pub. Emp. Retirement Bd.*, 338 Or. 145, 108 P.3d 1058, 1095 (2005) (rejecting state's "economic hardship affirmative defense," and finding that legislation eliminating annual assumed earning rate credit for employees and suspending annual cost-of-living adjustments for retirees violated contract clause in Oregon Constitution).

70. *American Fed'n of State, Cnty. & Municipal Emp. v. City of Benton*, 513 F.3d 874 (8th Cir. 2008).

Great Depression.”⁷¹ Because the city failed to demonstrate such a severe emergency, its plan was held not to constitute a public purpose and thus to violate the Contract Clause. This problematic analysis puts courts in the uncomfortable position of ascertaining when a financial crisis is serious enough to justify a contractual impairment. What criteria should be employed in making such a determination? Would any financial distress short of a general depression suffice? How much weight should be accorded a legislative declaration of economic difficulty?

Yet even a judicial finding of a valid public purpose might not be enough to save a cost-cutting scheme. A California appellate court invalidated on contract clause grounds fiscal-emergency legislation that withheld state funding of an employee retirement program.⁷² The court recognized the existence of a fiscal crisis in the state, and agreed that “the Legislature’s adoption of cost-cutting measures furthers an important public interest.”⁷³ Nonetheless, the court found that the lawmakers failed to consider the availability of less drastic measures to reach its goal and could not demonstrate an emergency justification for its impairment of the state’s contract.

In the same vein, several courts have taken the position that unilateral reduction of employee benefits was neither reasonable nor necessary in view of other available options. They suggested seeking additional federal aid, the reduction of other state services, or an increase of taxes, rather than contract impairment, as a solution to financial problems.⁷⁴ The Ninth Circuit expressed concern that public

71. *Id.* at 882.

72. *Valdes v. Cory*, 139 Cal. App.3d 773, 789–91, 189 Cal. Rptr. 212, 224–26 (3rd Dist. 1983).

73. *Id.* at 791, 189 Cal. Rptr. at 226.

74. *Univ. of Hawaii Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1107 (9th Cir. 1999); *Opinion of the Justices (Furlough)*, 135 N.H. 625, 636, 609 A.2d 1204, 1211 (1992) (“The legislature has many alternatives available to it, including reducing non-contractual State services and raising taxes and fees.”). *See also* *Donohue v. Paterson*, 715 F.2d 306, 322–25 (N.D.N.Y. 2010) (insisting that state must demonstrate that there were no reasonable alternatives to impairment of employee contracts, and must “explain why a particular level of savings must be obtained from state personnel”); *AFT Michigan v. State*, 297 Mich. App. 597, 825 N.W.2d 595, 603 (Mich. App. 2012), *application for leave to appeal pending* (“The state has not shown that it first undertook to reduce retiree health benefits, or to require present retirees to contribute to their own health care plans, or to restructure the benefits system in any way other than to legislate state-imposed modifications of freely-negotiated contracts.”); *Welch v. Brown*, 2013 WL 1292373 (E. D. Mich. 2013) (finding that actions by city in abrogating retiree health care plans to balance budget were not reasonable in view of failure to consider other options such as tax or service fee increases).

employees were being called upon to bear the brunt of addressing a budgetary crisis.⁷⁵ The Supreme Court of Oregon worried that failure to sustain a statutory pension system “would serve notice on any person who might consider embarking on a career in public service that the state’s promise could well prove to be worthless, even after the employees had given consideration for those promises in the form of partial performance.”⁷⁶ Given the general judicial neglect of the Contract Clause, this cluster of cases finding a constitutional violation represents a somewhat puzzling trend of invoking the clause in a narrow if important field.

Where does this mixed record leave us? Several observations are in order. First, the seemingly inconsistent results reached by different courts flow directly from the current test for analyzing claimed violations of the Contract Clause. The components of this test are so open-ended that one could justify almost any outcome.⁷⁷ Much depends on how much weight is assigned to legislative determinations.⁷⁸ Second, heightened review of public contracts puts courts in an ironic position. Having lectured for decades that courts should not interfere with social and economic policies, some courts and commentators have reversed gears and maintain that there is a duty to examine the reasonableness of legislative policy with regard to public employee contracts.⁷⁹ Consider, for instance, a suggestion by the First Circuit Court of Appeals regarding challenges to modification of public employee contracts. The court stated:

[I]f a state purports to impair a contract to address a budgetary crisis, a plaintiff could allege facts showing that the impairment did not save the state much money, the budget issues were not as severe as alleged by the state, or that other cost-cutting or

75. *Univ. of Hawaii Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1107 (9th Cir. 1999).

76. *Oregon Police Officers' Ass'n v. State*, 323 Or. 356, 918 P. 2d 765, 776 (1996).

77. Leo Clark, *The Contract Clause: A Basis for Limited Judicial Review of State Economic Regulation*, 39 U. MIAMI L. REV. 183, 253 (1985) (“Substantial gaps and ambiguities continue to plague the contract clause doctrine.”).

78. Nila M. Merola, *Judicial Review of State Legislation: An Ironic Return to Lochnerian Ideology When Public Sector Contracts Are Impaired*, 84 ST. JOHN'S L. REV. 1179, 1210 (2010) (“The dichotomous holdings and the varying level of deference afforded to the legislatures, both within and among the circuits, illustrate the inconsistencies amid the lower courts in applying the third prong of the *U.S. Trust* test.”).

79. *Id.* at 1211–17 (urging the application of strict scrutiny to state laws that impair public sector labor agreements).

revenue-increasing measures were reasonable alternatives to the contractual impairment at issue.⁸⁰

There is no evading the fact that such judicial scrutiny would entail difficult policy considerations. On what principled basis does a court decide whether a proposed alternative to benefit cuts is feasible or preferable? Would a tax increase negatively impact the business climate, and thus further exacerbate the budgetary crisis? Is a wage freeze more reasonable than layoffs, or reducing school or employee work hours? Should pension plans be funded if other creditors must go unpaid? There is no obvious answer to these questions.

III. TOWARD A PRINCIPLED CONTRACT CLAUSE

Litigation in this area is likely to continue as the budgetary shortfalls of states and localities show no signs of abating.⁸¹ Is there a way to escape the muddle of current contract clause jurisprudence? The partial revival of the clause with respect to public employee contracts may open the door to a more comprehensive reconsideration of the role of the provision in constitutional law. I propose a return to a principled reading of the Contract Clause.

The first step is to recall that the framers drafted the Constitution, and certainly the Contract Clause, against a background of financial distress in the post-Revolutionary era.⁸² It was the judgment of the framers that security of contracts even in troubled times was essential for economic growth.⁸³ It is revealing that the framers thought contractual arrangements were sufficiently vital to require a specific

80. *United Auto., Aerospace, Agric. Implement Workers v. Fortuno*, 633 F.3d 37, 45 (1st Cir. 2011).

81. In June of 2012 public-sector unions in Rhode Island filed a lawsuit challenging the state's overhaul of the public pension system alleging a violation, among other provisions, of the state constitution's contract clause. *See generally* Cuccinelli, Getchell & Russell, *supra* note 55, at 541 (predicting an increase in litigation flowing from alteration of public sector benefits).

82. *Blaisdell*, 290 U.S. at 453–65 (1934) (Sutherland, J., dissenting) (maintaining that the history surrounding the framing of Contract Clause makes clear that the provision was framed against background of economic hardship and was to apply with special force in times of financial distress).

83. James W. Ely, Jr., *Economic Liberties and the Original Meaning of the Constitution*, 45 SAN DIEGO L. REV. 673, 698–702 (2008). *See also* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 203 (3rd ed. 2005) (declaring that the Contract Clause reflected the notion that “business had to be able to rely on the stability of arrangements legally made, at least in the short and middle run. The contract clause guaranteed precisely that kind of stability, or tried to.”).

ban on state impairment at the same time that they felt a bill of rights was unnecessary.⁸⁴ The framers did not differentiate between public and private contracts, and certainly never suggested that financial problems at the state level should override contractual obligations. The very purpose of the clause was to curtail state authority.

The second step is to jettison the murky multi-prong test, and employ the same standard of review for public and private contracts.⁸⁵ Consistent with the language of the Contract Clause, any material state legislative impairment of an existing agreement or the remedies available for the enforcement of contracts should trigger careful judicial scrutiny. All contracts should be put on a level playing field. There should be no supine deference to legislative decisions with respect to either public or private contracts. Something more than conclusory statements about public welfare must be required before courts allow states to set aside private or public contracts. The Contract Clause does not provide that states may impair contracts whenever they contrive a reason.

Third, courts should be reluctant to see financial problems as an excuse for laws impairing contracts, whether mortgages, debts, bonds, or benefits promised public employees. It follows that, as a signal step toward a principled understanding of the Contract Clause, the *Blaisdell* opinion upholding a mortgage foreclosure moratorium should be overruled. Under my analysis, economic distress is not a justification for lifting the constitutional ban on the infringement of

84. *City of El Paso v. Simmons*, 379 U.S. 497, 523 (1965) (Black, J., dissenting) (stressing that the Contract Clause was “one of the few provisions which the Framers deemed of sufficient importance to place in the original Constitution along with companion clauses forbidding States to pass bills of attainder and *ex post facto* laws.”). See also Bruce Ackerman, *Constitutional Politics*, 99 YALE L. REV. 543, 537 (1989) (“Thus, the Federalists valued market ‘freedom’ so highly that they forbade the states from ‘impairing the obligation of Contracts’ in the original 1787 Constitution, at a time when they believed an elaborate Bill of Rights unnecessary.”).

85. Henry N. Butler & Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767, 793 (1989) (“There is no substantial justification for permitting the state to impair private contracts more readily than its own because legislators always act in their own self-interest, regardless of whether the putative goals appear to be to benefit the state, the public, or special interests.”); Michael W. McConnell, *Contract Rights and Property Rights: A Case Study in the Relationship Between Individual Liberties and Constitutional Structure*, 76 CAL. L. REV. 267, 293 (1988) (arguing that “the modern thrust of contract clause jurisprudence is precisely backward” and pointing out that “it is interference with private contracts that lies at the heart of the clause”); Thomas W. Merrill, *Public Contracts, Private Contracts, and the Transformation of the Constitutional Order*, 37 CASE WESTERN L. REV. 597, 629–39 (1987) (maintaining that “private and public contracts should be restored to an even playing field”).

contracts. That was the position which generally prevailed before *Blaisdell*. In 1933, for example, the Supreme Court of North Dakota emphatically rejected the contention that an economic emergency could justify legislation enlarging the period of redemption from mortgage foreclosures sales, and declared that “[i]t must not be forgotten that the right of private contracts is no small part of the liberty of the citizen”⁸⁶

A positive feature of my approach is that courts would no longer have to decide the appropriate level of review, and would have no need to address the vexing question of whether a particular legislative abridgement of a public contract is “reasonable and necessary.” Another advantage is that this mode of analysis will provide greater predictability in Contract Clause litigation.⁸⁷ Finally, I submit that this construction of the Contract Clause is more faithful to the history, purpose, and text of the provision than is the present jumble.

How would my proposed reading of the Contract Clause impact litigation over legislative modifications of public sector employee contracts? In some respects such a change in constitutional doctrine would hamper the prosecution of claims for contractual impairment by public employees. There would no longer be an elevated level of judicial review when a state abridged its own contracts, as all agreements would be protected to the same extent. In particular, there would be no room for the suggestion that public employees deserve special attention by the courts.⁸⁸ Any such a result should be seen as manifestly unprincipled and calculated to benefit one interest group.⁸⁹ While public employees should not be singled out for harsh

86. *State ex rel. Cleveringa v. Klein*, 249 N.W. 118, 124–28 (N.D. 1933).

87. *Kmiec & McGinnis*, *supra* note 45, at 559 (pointing out that under its present test “the Supreme Court has interpreted a constitutional provision that was designed to provide certainty to contracting parties in a manner that maximizes the unpredictability of its application”).

88. *See Merola*, *supra* note 77, at 1211 (asserting that “enormous public interest . . . demands that strict scrutiny be applied to laws that impair public sector labor contracts,” and insisting that “public employees deserve the utmost protection”). *See also* *Univ. of Hawaii Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1105–06 (9th Cir. 1999) (advancing similar argument); *Ass'n of Surrogates & Sup. Ct. Reporters v. New York*, 940 F.2d 766, 772 (2nd Cir. 1991) (stressing impact of lag payroll on affected state employees).

89. Result-oriented jurisprudence, of course, is hardly new. *See generally* Martin Shapiro, *The Supreme Court's "Return" to Economic Regulation*, 1 *STUD. IN AM. POL. DEV.* 91, 93 (1986) (pointing out that after 1937 the Supreme Court abandoned the use of substantive due process to safeguard traditional property, but created rights under the rubric of due process “for the numerous clients of the New Deal, that is, government employees, the recipients of government benefits, intellectuals, racial minorities, and underdogs generally”).

treatment in economically distressed times, neither should they be treated as a privileged class. What is good for the goose should be good for the gander. Indeed, one could argue that government as an employer needs greater freedom than private employers to adjust workplace relationships.⁹⁰

At the same time, public employees might benefit from my proposal to restore vigor and consistency to the Contract Clause. In the early twentieth century the Supreme Court began to rule that legislative police power encompassed the authority to modify agreements in order to deal with economic problems. Recall that in *Blaisdell* the Court upheld state legislation to postpone mortgage foreclosures. But the Court soon moved beyond private contracts. Similar reasoning was applied in the context of municipal debts. There is authority that a state, faced with a financial emergency, can restructure municipal debt even if some creditors suffer a loss. In *Faitoute Iron & Steel Co. v. City of Asbury Park* (1942) the Supreme Court declared: “The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city’s debt is implied in every obligation for the very reason that thereby the obligation is discharged, not impaired.”⁹¹ This language suggests the existence of a reserved power to alter contracts to address municipal debt if financial circumstances warrant. *Faitoute* could well lend support to efforts of state and local government to roll back public employee benefits. If a state can alter bonded obligations to the detriment of creditors, why cannot a state modify public employee contracts? My proposal, however, points in another direction. The mere existence of budgetary problems would not constitute a justification for impairing private or public contracts, including public employee contracts.

Other aspects of my proposed approach would also assist potential public employee claims. Consider, for example, the element of foreseeability, often mentioned by courts under the current test in the context of ascertaining the expectations of the contracting parties or in determining whether a state’s actions were reasonable. Foreseeability could easily prove a two-edged sword. True, some local governments were already experiencing financial difficulties when collective

90. *Alston v. City of Camden*, S.C., 332 S.C. 38, 471 S.E.2d 174, 179 (1996) (“If anything, government should have more flexibility than business with respect to the employer/employee relationship.”).

91. 316 U.S. 502, 511 (1942) (Frankfurter, J.) (rejecting a contract clause challenge to a state plan adjusting rights of bondholders of insolvent municipality).

bargaining agreements were negotiated or benefit schemes were enacted. By the same token, however, employees must also have been aware of deep financial problems afflicting the community. Indeed, financial experts have been warning for years that public employee pension funds were radically underfunded. This was hardly a secret for either local governments or public sector unions.⁹² It is consequently quite possible that courts could conclude that employees must have understood that tight budgetary realities might frustrate fulfillment of collective bargaining agreements or statutory schemes. In a related field, the Seventh Circuit Court of Appeals upheld a state law curbing the collective bargaining rights of public employee unions and revealingly commented that the statute reflected “a rational belief that public sector unions are too costly for the state.”⁹³ This reasoning might find application in Contract Clause cases as well, to the detriment of employee claimants.

To my mind, loose considerations of whether an economic emergency was expected and foreseeable should have no bearing on Contract Clause analysis. Courts should no longer consult a crystal ball to decide whether a changed financial picture was foreseeable. The fact of a legislative impairment, not the reasonableness of the state’s actions, would be the determinative issue.

I certainly make no claim that this brief essay resolves all the interpretative difficulties pertaining to the Contract Clause. Still, it seems apparent that we are presently on the wrong path and that current contract clause jurisprudence is deeply flawed. The Supreme Court, followed by some state courts, pays lip service to the importance of the Contract Clause and then formulates pliable tests that, as a practical matter, undercut the protective function of the provision against legislative interference with existing agreements. Perhaps the revival of interest in the Contract Clause with respect to public employee labor agreements will serve as a catalyst for a broad reconsideration and revitalization of the provision. Failing such a fresh look, any application of the clause to sustain public employee contracts looks like an anomaly calculated to serve the economic interests of one particular group.

92. The financial problems have been evident for decades. Facing a severe fiscal crisis in the mid-1970s, New York City imposed a wage freeze for municipal employees. See Comment, *The Constitutionality of the New York Municipal Wage Freeze and Debt Moratorium: Resurrection of the Contract Clause*, 125 U. PA. L. REV. 167 (1976).

93. *Wisconsin Educ. Ass’n Council v. Walker*, 705 F.3d 640, 656 (7th Cir. 2013).