

AMERICAN CONSTITUTIONALISM
VOLUME II: RIGHTS AND LIBERTIES
Howard Gillman • Mark A. Graber • Keith E. Whittington

Supplementary Material

Chapter 9: Liberalism Divided – Individual Rights/Property/Contracts

U.S. Trust Co. of New York v. New Jersey, 431 U.S. 1 (1977)

The U.S. Trust Company of New York served as a trustee for several Port Authority bonds. New York and New Jersey in 1962, concerned with investor confidence in the Port Authority, passed laws forbidding moneys obtained by Port Authority bonds from being used to subsidize railroad transportation. The statute explicitly asserted that “The 2 States covenant and agree with each other and with the holders of any affected bonds that . . . neither the States nor the port authority . . . will apply any of the . . . revenues or reserves, which have been or shall be pledged . . . as security for such bonds, for any railroad purposes.” As transportation and financial woes increased, both states first repealed those laws in 1972 and then in 1974 declared that the repeal would have retroactive effect. The U.S. Trust Company immediately filed a lawsuit asking for a judgment forbidding New Jersey from acting inconsistently with the 1962 covenant. After both a lower New Jersey court and the Supreme Court of New Jersey rejected that claim, U.S. Trust appealed to the Supreme Court of the United States. The Securities Industry Association filed an amicus brief on behalf of U.S. Trust. That brief declared,

For the entire investment community this covenant epitomized the security—an inviolate contract—essential to persuade investors that the bonds to be purchased were based on sound credit standards. The continuing integrity of such covenants is essential so that state and municipal governments may market their bonds successfully. The repeal of the 1962 Covenant was destructive of investor confidence and has had a severe impact on public credit. Accordingly, the ability of states and municipal governments to finance capital projects at reasonable rates is inextricably involved in this controversy.

The Supreme Court of the United States reversed the previous decision by a 4-3 vote. Justice Blackmun’s majority opinion insisted that the court should scrutinize more strictly state laws impairing state contracts than state laws impairing private contracts. Blackmun also insisted that the judicial decision that New Jersey violated the contracts clause is consistent with past decisions holding that states may not contract away the power to regulate for the health, safety, and welfare of the people. How did he distinguish U.S. Trust from those past decisions? Do you find that distinction convincing? Justice Blackmun and Justice Brennan disputed whether state laws impairing state contracts should receive stricter contracts clause scrutiny than state laws impairing private contracts. What arguments did these justices make on behalf of their position? What position do you believe is constitutionally correct? Justice Brennan concluded his dissent by asserting that the bond market can be trusted to punish states that repeal obligations. States with reputations for defaulting on obligations, in this view, will find raising money much harder in the future. Is this analysis economically sound? Is this analysis constitutionally relevant?

JUSTICE BLACKMUN delivered the opinion of the Court.

...
... Whether or not the protection of contract rights comports with current views of wise public policy, the Contract Clause remains a part of our written Constitution. We therefore must attempt to apply that constitutional provision to the instant case with due respect for its purpose and the prior decisions of this Court.

. . . It long has been established that the Contract Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties. . . . Yet the Contract Clause does not prohibit the States from repealing or amending statutes generally, or from enacting legislation with retroactive effects. Thus, as a preliminary matter, appellant's claim requires a determination that the repeal has the effect of impairing a contractual obligation.

. . . [T]he 1962 covenant constituted a contract between the two States and the holders of the Consolidated Bonds issued between 1962 and the 1973 prospective repeal. The intent to make a contract is clear from the statutory language: "The 2 States covenant and agree with each other and with the holders of any affected bonds. . . ." Moreover, as the chronology set forth above reveals, the purpose of the covenant was to invoke the constitutional protection of the Contract Clause as security against repeal.

...

The trial court recognized that there was an impairment in this case:

"To the extent that the repeal of the covenant authorizes the Authority to assume great deficits for such purposes, it permits a diminution of the pledged revenues and reserves, and may be said to constitute an impairment of the states' contract with the bondholders."

Having thus established that the repeal impaired a contractual obligation of the States, we turn to the question whether that impairment violated the Contract Clause.

Although the Contract Clause appears literally to proscribe "any" impairment, this Court observed in *Home Building & Loan Association v. Blaisdell* (1934) that "the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula." . . . Thus, a finding that there has been a technical impairment is merely a preliminary step in resolving the more difficult question whether that impairment is permitted under the Constitution. . . . [W]e must attempt to reconcile the strictures of the Contract Clause with the "essential attributes of sovereign power" . . . necessarily reserved by the States to safeguard the welfare of their citizens. . . .

The trial court concluded that repeal of the 1962 covenant was a valid exercise of New Jersey's police power because repeal served important public interests in mass transportation, energy conservation, and environmental protection. Yet the Contract Clause limits otherwise legitimate exercises of state legislative authority, and the existence of an important public interest is not always sufficient to overcome that limitation. . . . Moreover, the scope of the State's reserved power depends on the nature of the contractual relationship with which the challenged law conflicts.

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. Otherwise, one would be able to obtain immunity from state regulation by making private contractual arrangements. . . .

When a State impairs the obligation of its own contract, the reserved powers doctrine has a different basis. The initial inquiry concerns the ability of the State to enter into an agreement that limits its power to act in the future. As early as *Fletcher v. Peck* (1810), the Court considered the argument that "one legislature cannot abridge the powers of a succeeding legislature." . . . It is often stated that "the legislature cannot bargain away the police power of a State." *Stone v. Mississippi* (1880). . . . This doctrine requires a determination of the State's power to create irrevocable contract rights in the first place, rather than an inquiry into the purpose or reasonableness of the subsequent impairment. In short, the Contract Clause does not require a State to adhere to a contract that surrenders an essential attribute of its sovereignty.

. . . Whatever the propriety of a State's binding itself to a future course of conduct in other contexts, the power to enter into effective financial contracts cannot be questioned. Any financial obligation could be regarded in theory as a relinquishment of the State's spending power, since money spent to repay debts is not available for other purposes. Similarly, the taxing power may have to be exercised if debts are to be repaid. Notwithstanding these effects, the Court has regularly held that the States are bound by their debt contracts. The instant case involves a financial obligation, and thus, as a

threshold matter, may not be said automatically to fall within the reserved powers that cannot be contracted away. [T]he States promised that revenues and reserves securing the bonds would not be depleted by the Port Authority's operation of deficit-producing passenger railroads beyond the level of "permitted deficits." Such a promise is purely financial, and thus not necessarily a compromise of the State's reserved powers.

... [A]n impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. In applying this standard, however, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake. A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. ...

... The extent of impairment is certainly a relevant factor in determining its reasonableness. But we cannot sustain the repeal of the 1962 covenant simply because the bondholders' rights were not totally destroyed.

... Mass transportation, energy conservation, and environmental protection are goals that are important, and of legitimate public concern. Appellees contend that these goals are so important that any harm to bondholders from repeal of the 1962 covenant is greatly outweighed by the public benefit. We do not accept this invitation to engage in a utilitarian comparison of public benefit and private loss. ... [T]he Court has not "balanced away" the limitation on state action imposed by the Contract Clause. Thus, a State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good, rather than the private welfare of its creditors. We can only sustain the repeal of the 1962 covenant if that impairment was both reasonable and necessary to serve the admittedly important purposes claimed by the State.

The more specific justification offered for the repeal of the 1962 covenant was the States' plan for encouraging users of private automobiles to shift to public transportation. The States intended to discourage private automobile use by raising bridge and tunnel tolls and to use the extra revenue from those tolls to subsidize improved commuter railroad service. Appellees contend that repeal of the 1962 covenant was necessary to implement this plan because the new mass transit facilities could not possibly be self-supporting and the covenant's "permitted deficits" level had already been exceeded. We reject this justification because the repeal was neither necessary to achievement of the plan nor reasonable in light of the circumstances.

The determination of necessity can be considered on two levels. First, it cannot be said that total repeal of the covenant was essential; a less drastic modification would have permitted the contemplated plan without entirely removing the covenant's limitations on the use of Port Authority revenues and reserves to subsidize commuter railroads. Second, without modifying the covenant at all, the States could have adopted alternative means of achieving their twin goals of discouraging automobile use and improving mass transit. Appellees contend however, that choosing among these alternatives is a matter for legislative discretion. But a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives. Similarly, a State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well. ...

CHIEF JUSTICE BURGER, concurring.

In my view, to repeal the 1962 covenant without running afoul of the constitutional prohibition against the impairment of contracts, the State must demonstrate that the impairment was essential to the achievement of an important state purpose. Furthermore, the State must show that it did not know and could not have known the impact of the contract on that state interest at the time that the contract was made. So reading the Court's opinion, I join it.

JUSTICE BRENNAN, with whom JUSTICE WHITE and JUSTICE MARSHALL join, dissenting.

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 exercises of a State's police powers stand paramount to private rights held under contract. Today's decision, in invalidating the New Jersey Legislature's 1974 repeal of its predecessor's 1962 covenant, rejects this previous understanding and remolds the Contract Clause into a potent instrument for overseeing important policy determinations of the state legislature. At the same time, by creating a constitutional safe haven for property rights embodied in a contract, the decision substantially distorts modern constitutional jurisprudence governing regulation of private economic interests. I might understand, though I could not accept, this revival of the Contract Clause were it in accordance with some coherent and constructive view of public policy. But elevation of the Clause to the status of regulator of the municipal bond market at the heavy price of frustration of sound legislative policymaking is as demonstrably unwise as it is unnecessary. The justification for today's decision, therefore, remains a mystery to me, and I respectfully dissent.

. . . In my view, the Court's casual consideration both of the substantial public policies that prompted New Jersey's repeal of the 1962 covenant and of the relatively inconsequential burdens that resulted for the Authority's creditors belies its conclusion that the State acted unreasonably in seeking to relieve its citizens from the strictures of this earlier legislative policy.

. . . The Court never explicitly takes issue with the core of New Jersey's defense of the repeal: that the State was faced with serious and growing environmental, energy, and transportation problems, and the covenant worked at cross-purposes with efforts at remedying these concerns

. . . The Court's various alternative proposals, while perhaps interesting speculations, simply are not responsive to New York's and New Jersey's real environmental and traffic problems, and, in any event, intrude the Court deeply into complex and localized policy matters that are for the States' legislatures, and not the judiciary, to resolve.

Equally unconvincing is the Court's contention that repeal of the 1962 covenant was unreasonable because the environmental and energy concerns that prompted such action "were not unknown in 1962, and the subsequent changes were of degree, and not of kind." Nowhere are we told why a state policy, no matter how responsive to the general welfare of its citizens, can be reasonable only if it confronts issues that previously were absolutely unforeseen. . . .

If the Court's treatment of New Jersey's legitimate policy interests is inadequate, its consideration of the countervailing injury ostensibly suffered by the appellant is barely discernible at all. For the Court apparently holds that a mere "technical impairment" of contract suffices to subject New Jersey's repealer to serious judicial scrutiny and invalidation under the Contract Clause. . . . The Court's modest statement of the economic injury that today attracts its judicial intervention is, however, understandable. For, fairly read, the record before us makes plain that the repeal of the 1962 covenant has occasioned only the most minimal damage on the part of the Authority's bondholders.

Obviously, the heart of the obligation to the bondholders . . . is the periodic payment of interest and the repayment of principal when due. The Court does not, and indeed cannot, contend that either New Jersey or the Authority has called into question the validity of these underlying obligations. . . .

. . . The Court today dusts off the Contract Clause, and thereby undermines the bipartisan policies of two States that manifestly seek to further the legitimate needs of their citizens. The Court's analysis, I submit, fundamentally misconceives the nature of the Contract Clause guarantee.

One of the fundamental premises of our popular democracy is that each generation of representatives can and will remain responsive to the needs and desires of those whom they represent. Crucial to this end is the assurance that new legislators will not automatically be bound by the policies and undertakings of earlier days. In accordance with this philosophy, the Framers of our Constitution conceived of the Contract Clause primarily as protection for economic transactions entered into by purely

private parties, rather than obligations involving the State itself. . . . The Framers fully recognized that nothing would so jeopardize the legitimacy of a system of government that relies upon the ebbs and flows of politics to “clean out the rascals” than the possibility that those same rascals might perpetuate their policies simply by locking them into binding contracts.

Following an early opinion of the Court, however, that took the first step of applying the Contract Clause to public undertakings, *Fletcher v. Peck* (1810), . . . later decisions attempted to define the reach of the Clause consistently with the demands of our governing processes. The central principle developed by these decisions, beginning at least a century ago, has been that Contract Clause challenges such as that raised by appellant are to be resolved by according unusual deference to the lawmaking authority of state and local governments. . . .

This theme of judicial self-restraint and its underlying premise that a State always retains the sovereign authority to legislate in behalf of its people was commonly expressed by the doctrine that the Contract Clause will not even recognize efforts of a State to enter into contracts limiting the authority of succeeding legislators to enact laws in behalf of the health, safety, and similar collective interests of the polity—in short, that that State’s police power is inalienable by contract. . . .

. . . By invalidating the 1974 New Jersey repeal—and, by necessity, like action by New York—the Court regrettably departs from the virtually unbroken line of our cases that remained true to the principle that all private rights of property, even if acquired through contract with the State, are subordinated to reasonable exercises of the States’ lawmaking powers in the areas of health, . . . environmental protection . . . and transportation. . . .

. . . Today’s decision cannot be harmonized with our earlier cases by the simple expedient of labeling the covenant “purely financial,” rather than a forfeiture of “an essential attribute of [New Jersey’s] sovereignty.” . . . As either an analytical or practical matter, this distinction is illusory. It rests upon an analytical foundation that has long been discarded as unhelpful. And as a purely practical matter, an interference with state policy is no less intrusive because a contract prohibits the State from resorting to the most realistic and effective financial method of preserving its citizens’ legitimate interests in healthy and safe transportation systems, rather than directly proscribing the States from exercising their police powers in this area. . . .

. . .
The Court’s willingness to uphold an impairment of contract—no matter how “technical” the injury—only on a showing of “necessity” . . . is particularly distressing, for this Court always will be able to devise abstract alternatives to the concrete action actually taken by a State. For example, in virtually every decided Contract Clause case, the government could have exercised the Court’s “lesser alternative” of resorting to its powers of taxation as a substitute for modifying overly restrictive contracts. . . . Yet, in all these cases, modifications of state contracts were countenanced, and this Court did not feel compelled or qualified to instruct the state legislatures how best to pursue their business. In brief, these cases recognized that, when economic matters are concerned, “the availability of alternatives does not render the [decision maker’s] choice invalid.” . . .

Given that this is the first case in some 40 years in which this Court has seen fit to invalidate purely economic and social legislation on the strength of the Contract Clause, one may only hope that it will prove a rare phenomenon, turning on the Court’s particularized appraisal of the facts before it. But there also is reason for broader concern. It is worth remembering that there is nothing sacrosanct about a contract. All property rights, no less than a contract, are rooted in certain “expectations” about the sanctity of one’s right of ownership. . . . If today’s case signals a return to substantive constitutional review of States’ policies, and a new resolve to protect property owners whose interest or circumstances may happen to appeal to Members of this Court, then more than the citizens of New Jersey and New York will be the losers.

I would not want to be read as suggesting that the States should blithely proceed down the path of repudiating their obligations, financial or otherwise. Their credibility in the credit market obviously is highly dependent on exercising their vast lawmaking powers with self-restraint and discipline, and I, for one, have little doubt that few, if any, jurisdictions would choose to use their authority “so foolish[ly] as to kill a goose that lays golden eggs for them.” . . . But in the final analysis, there is no reason to doubt

that appellant's financial welfare is being adequately policed by the political processes and the bond marketplace itself. The role to be played by the Constitution is, at most, a limited one. . . . For this Court should have learned long ago that the Constitution—be it through the Contract or Due Process Clause—can actively intrude into such economic and policy matters only if my Brethren are prepared to bear enormous institutional and social costs. Because I consider the potential dangers of such judicial interference to be intolerable, I dissent.



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