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Recommended Citation
https://scholar.smu.edu/smulr/vol66/iss4/2

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THE ECONOMIC PURPOSE OF THE CONTRACT CLAUSE

David Crump*

ARTICLE I, Section 10 of the Constitution provides that no state shall make any law "impairing the obligation of contracts."¹ After a flurry of applications following ratification of the Constitution, which generally upheld contracts by striking down state-enacted impairs,² this clause fell into a long era of disuse. In Stone v. Mississippi, the Supreme Court held that a state was powerless to bind its regulatory authority so as to prevent the state from ensuring the public health, safety, and welfare.³ This holding destroyed the effectiveness of the Contract Clause, because if a state was free to change laws that otherwise would uphold contracts, it was free to impair contractual obligations.⁴ Later, in Home Building & Loan Ass'n v. Blaisdell, the Supreme Court upheld a debtor relief act in an opinion that seemed, by its rhetoric, to put the Contract Clause out of business.⁵

In the modern era, however, the clause has undergone a Renaissance. In United States Trust Co. of New York v. New Jersey, the Supreme Court struck down a state's attempt to impair contractual security for bonds.⁶ Then, in Allied Structural Steel Co. v. Spannus, the Court reinterpreted its prior Blaisdell decision, holding that in the event of a nontrivial contract impairment, state legislation could be upheld only in the event that five important factors⁷ present in Blaisdell coalesced. "[T]he Contract Clause remains part of the Constitution," said the Court, "It is not a dead

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In spite of this resurrection, the Contract Clause faces uneven interpretation, and even in recent decisions, the courts are inconsistent about recognizing the purpose of the clause. To this day, the opinions remain difficult to reconcile, either with each other or with the original intent, and recent decisions dispose of Contract Clause cases without considering the purpose of the clause. This Article is unique in comparing the original intent to both earlier and recent cases.

The Supreme Court's reasoning in Allied tolerates some impairments of contract, but, excepting the situations in decided cases, outcomes remain difficult to predict. The five-factor Allied-Blaisdell test is subject to extensive manipulation. Furthermore, a sufficiently "substantial" or "severe" impairment, as opposed to an insubstantial or trivial one that would not trigger scrutiny under the five factors, is also difficult to recognize. There is lacking a clear vision of the purpose of the Contract Clause, and hence the application of the tests the Supreme Court has generated fails to produce a unified theory of its meaning.

This Article begins with the history underlying the adoption of the Contract Clause. Ascertaining legislative or constitutional intent by examination of history is a well-known aid to interpretation when textual analysis fails to resolve ambiguity, especially for provisions that implicate "reliance and expectation values," and therefore original intent is a particularly appropriate consideration in the interpretation of the Contract Clause. In fact, portions of the history set forth here are cited in Supreme Court opinions, though they are used there only in limited ways. The historical exposition that appears here is original to the author, and previous writings about the Contract Clause do not develop the meaning of the clause in this way.

After developing the history of its adoption, this Article contrasts the economic purpose of the Contract Clause with the minority-rights orientation of the Due Process Clause. This Article shows that the different purposes can give different results in concrete cases. Thereafter, this Arti-
cle examines the application of the Contract Clause in both historic cases and recent cases. In the course of this analysis, this Article notes instances in which the reasoning of the courts does not mirror the economic purposes of the Founders, as well as cases in which the reasoning seems consistent with the original intent.

The final section of this Article summarizes the author's conclusions, which center upon a simple thesis. The Contract Clause, unlike other parts of the Constitution with which it has occasionally been confused, is not a protection of fairness to minority interests. Instead, it was enacted for economic reasons. Its purpose was to preserve investor confidence and thereby make capital more readily available by ensuring the investor that a faithless government would not deprive him or her of the benefit of the bargain after the risk had been run. This rationale emerges unmistakably from the constitutional history, and although it does not explain all of the decisions of the courts, it is consistent with the bulk of them. The original Constitution was in large measure an economic document, and although there also are important clauses guaranteeing fair treatment to minority interests, there remain clauses, such as the Contract Clause, that can be properly understood only if their economic purpose is kept in mind.

I. AN INVESTOR-CONFIDENCE THEORY OF THE CONTRACT CLAUSE: THE ORIGINAL UNDERSTANDING

A. THE CLIMATE OF OPINION IN WHICH THE CONTRACT CLAUSE WAS ADOPTED

Thirteen years before the adoption of the Constitution, Adam Smith published his famous Inquiry into the Nature and Causes of the Wealth of Nations. This description of the "invisible hand," by which the price system regulated production and consumption better than government ever could, took the civilized world by storm after a brief period of gestation. Within eight years, Wealth of Nations had been cited on the floor of Parliament. About the time of ratification of the Constitution, the Prime Minister of England stood when Adam Smith entered the room and said, "we are all your scholars." As one historian put it, "all the Western World became the world of Adam Smith."

Adam Smith explained the allocative function of the market. As one economic historian put it, Smith showed, "First, . . . how prices are kept

16. See infra Parts III–IV.
17. See id.
19. Id. at 49.
20. Id. at 61.
21. Id. at 67.
22. Id. at 37.
23. Id.
from ranging arbitrarily away from the actual cost of producing a good. Second, . . . how society can induce its producers . . . to provide . . . what it wants. Third, . . . why high prices are a self-curing disease, for they cause production . . . to increase." Smith also explained the capital market and the effect of risk on investment, and he made the following specific observations on the need to enforce contracts:

A defect in the law may sometimes raise the rate of interest considerably above what the condition of the country, as to wealth or poverty, would require. When the law does not enforce the performance of contracts, it puts all borrowers nearly upon the same footing with bankrupts or people of doubtful credit in better regulated countries. The uncertainty of recovering his money makes the lender exact the same usurious interest which is usually required from bankrupts.

Smith's observations on the abrogation of contracts were a part of the intellectual climate in which the Constitution was adopted thirteen years later. Professors Tuttle and Perry asserted that acceptance of the ideas of Adam Smith was well-nigh universal among the drafters of the Constitution. Economic historian Robert Heilbroner stated that Wealth of Nations became "an economic blueprint" for the new American State. Also, Smith cited Montesquieu, who had earlier explained the premium for uncertainty of performance that investors demand in jurisdictions where contracts can be abrogated. The work of Montesquieu was familiar to the Founders, who quoted him while drafting the Constitution.

B. DESTRUCTION OF THE AMERICAN ECONOMY BY CONTRACT ABROGATION DURING THE ARTICLES OF CONFEDERATION PERIOD

The drafters of the Constitution personally experienced the evils Adam Smith and Montesquieu had written about. The American Revolution was followed by a severe postwar depression. This event coincided with the Articles of Confederation, which did not place restraints upon the regulation of trade by individual states. The principal cause of the Con-

24. Id. at 52.
26. FRANK W. TUTTLE & JOSEPH M. PERRY, AN ECONOMIC HISTORY OF THE UNITED STATES 105 (1970). For examples of the Founders' arguments indicating understanding and acceptance of Smith's market theory, see 2 JONATHAN ELLIOT, ELLIOT'S DEBATES ON THE CONSTITUTION 139 (2d ed. 1901) [hereinafter ELLIOT'S DEBATES] (remarks of Massachusetts delegate Russell as to allocative effects of competitive market in "calling forth resources" and regulating demand); 4 ELLIOT'S DEBATES, supra, at 298 (remarks of South Carolina delegate Mathews indicating that natural competition, rather than regulation, would ensure against charging of "excessive freightage" by shippers).
27. HEILBRONER, supra note 18, at 37.
28. SMITH, supra note 25, at 112.
29. Id. at 112 n.33; 3 ELLIOT'S DEBATES, supra note 26, at 280 (Montesquieu cited in debate on ratification in Massachusetts).
30. TUTTLE & PERRY, supra note 26, at 105.
31. Id.
stitutional Convention was the action of faithless states in trying to solve the problems of postwar depression by allowing paper securities to become worthless and by abrogating private contracts so as to benefit the abrogating states' citizens at the expense of creditors. These events caused the Founders to echo the words of Adam Smith about the need for contract enforcement to ensure capital availability. For example, James Madison explained the conditions that led to the Constitutional Convention thus:

In the internal administration of the states, a violation of contracts had become familiar, in the form of depreciated paper made a legal tender, of property substituted for money, of installment laws, and of the occlusions of the courts of justice, although evident that all such interferences affected the rights of other states, relatively creditors, as well as citizens creditors within the state. . . .

As a natural consequence of this distracted and disheartening condition of the Union, the federal authority had ceased to be respected abroad. . . . At home, it had lost all confidence and credit; the unstable and unjust career of the states had also forfeited the respect and confidence essential to order and good government, involving a general decay of confidence and credit between man and man.

The authors of the Federalist advanced similar causes: "The sober people of America are weary of the fluctuating policy which has directed the public councils," they wrote, destroying the economy by destroying "necessary confidence" in investment. They predicted that the Contract Clause would "give a regular course to the business of society."

Historians have repeatedly observed that the most important concerns underlying the original Constitution were economic. With specific reference to the Contract Clause, one commentator has written that "as long as a strong rationalization for capitalistic power existed in economic thought and opinion, the civil liberties and minority rights argument was secondary." Another economic historian, Charles Beard, explained the conditions that gave rise to the Contract Clause by referring to the clash of interests of mercantilists (interested in protecting personality and trade) and agrarians (interested in protecting land):

Equally important to personality as the positive powers conferred upon Congress . . . were the restrictions imposed on the States. Indeed, we have the high authority of Madison . . . that of the forces which created the Constitution, those property interests seeking protection against omnipotent [State] legislatures were the most active.

32. See Charles A. Beard, An Economic Interpretation of the Constitution of the United States 180 (1956); Tuttle & Perry, supra note 26, at 106.
33. 5 Elliot's Debates, supra note 26, at 120.
34. The Federalist No. 44 (James Madison).
35. Id.; Beard, supra note 32, at 180.
Two small clauses embody the chief demands of personality against agrarianism: the emission of paper money is prohibited and the states are forbidden to impair the obligation of contract. ... Money lenders and security holders may be sure of their operations. Contracts are to be safe, and whoever engages in a financial operation, public or private, may know that state legislatures cannot destroy overnight the rules by which the game is played.37

Beard added, "A principle of deep significance is written in these two brief sentences. The economic history of the states between the Revolution and the adoption of the Constitution is compressed in them."38

C. THE DEBATE IN THE CONVENTION: ECONOMIC CONCERNS

Debate on the Contract Clause in the Constitutional Convention was not extensive. However, such debate as there was shows that inclusion of the clause was motivated by the economic concerns mentioned by Madison. The delegates had recognized the harm to investment caused by insecure money, and they realized that the States could create the same kinds of harm by abrogating contracts. Records of the debates show the following:

Aug. 28 Article XII [predecessor to Section 10] being taken up:

Mr. Wilson [and] Mr. Sherman moved to insert after the words "coin money" the words "nor emit bills of credit, nor make any thing but gold and silver coin a tender in payment of debts."

....

Mr. Sherman thought this a favorable crisis for crushing paper money. ....

Mr. King moved to add ... a prohibition on the states to interfere with private contracts.

Mr. Govr. Morris. This would be going too far. There are a thousand laws relating to bringing actions—limitations of actions [and] which affect contracts ...; a majority must rule, whatever may be the mischief done among themselves.

Mr. Sherman. Why then prohibit bills of credit?

Mr. Wilson was in favor of Mr. King's motion.

Mr. Madison admitted that inconveniences might arise from such a prohibition but thought on the whole it would be overbalanced by the utility of it.39

It can thus be seen that the Contract Clause immediately followed the State Money Clause in the debate, and that the delegates who had proposed the State Money Clause (Wilson and Sherman) immediately spoke for the Contract Clause, regarding them as similarly motivated to protect

38. Id. at 179.
investment ("Why then prohibit bills of credit?"). The debate then turned to other economic issues—including embargoes, imposts, duties on imports, the taxing power, the general commerce power, and bankruptcy—and returned to the Contract Clause to refer it to the committee on Style the following day.

When Section 10 was adopted by the Convention a few days later, the only recorded comment was that of delegate Gerry of Massachusetts, who "entered into observations inculcating the importance of public faith, and the propriety of the restraint put on the States from impairing the obligation of contracts—Alleging that Congress ought to be laid under the like prohibitions. . . . He was not 2ded."

On the day of its adoption, as earlier, the Contract Clause was surrounded by, and related to, debate on other economic issues. Given the context and the history, it is clear that Gerry's reference to "public faith" meant confidence in the enforcement of contracts that would produce venture capital.

D. DEBATES ON RATIFICATION: CONCERN ABOUT CREDIT, CAPITAL, INTEREST RATES, AND FOREIGN DEBT

In those states in which the Contract Clause was actually debated during ratification, the purpose of the clause clearly emerged as that of protecting the availability of capital in a free economy. For example, Charles Pinckney, one of the drafters of the Constitution and South Carolina's foremost spokesman, began his remarks supporting ratification by decrying the "loss of credit" resulting from the "inefficacy of the Confederation." He attributed the calling of the Convention to the "destruction of commerce, of public credit, private confidence and national character. . . ." Thereafter, he spoke directly in support of the Contract Clause, as follows:

This section I consider as the soul of the Constitution. . . .

. . . .

Henceforth, the citizens of the states may trade with each other without fear of tender-laws or laws impairing the nature of contracts. The citizen of South Carolina will be able to trade with those of Rhode Island, North Carolina, and Georgia, and be sure of receiving the value of his commodities. Can this be done at present? It cannot! . . .

But above all, how much will this section tend to restore your credit with foreigners . . .! No more shall paper money, no more shall tender-laws, drive their commerce from our shores, and darken the American name in every country where it is known. No more

41. Id.
42. Id. at 619.
43. 4 Elliot's Debates, supra note 26, at 253. This subject matter was the opening point and focus of debate in South Carolina.
44. Id. at 255.
shall our citizens conceal in their coffers those treasures which the weakness and dishonesty of our government have long hidden from the public eye. . . . Public as well as private confidence shall again be established; industry shall return among us. . . .

In Pennsylvania, a legislator who had also been a Convention delegate supported the Contract Clause by arguing that its absence had caused paper to pass at a “twenty-five or thirty [percent] discount” in a neighboring state.46 Similarly, in North Carolina and Virginia, the Contract Clause was viewed as having the purpose of safeguarding investment.47

In states in which the Contract Clause was not directly mentioned, the need for protection of capital emerged as a foremost concern. For example, in Massachusetts, one delegate supported limitations on the powers of the States by the following argument: “Our credit is reduced to so low an ebb, that American faith is a proverbial expression for perfidy, as Punic faith was among the Romans. Thus have we suffered every species of infamy abroad, and poverty at home.”48

The interest that American states were made to pay to procure loans in Europe, owing to abrogations of contract, was a frequent point in the ratification debates. Thus in Connecticut, one delegate argued that State abrogation of contracts had driven America to “the wretched expedient of negotiating new loans in Europe,” at higher interest, “to pay the interest of the foreign debt.”49 He predicted the inability of the nation to raise new money even to pay for “an ox” if such contractual debts were abrogated.50

Finally, Alexander Hamilton pointed out that “private credit” was difficult to obtain in some states, including New York.51 He attributed this failure of capital to the tendency of states to “throw off their burdens of government upon their neighbors.”52 If private capital was available, said Hamilton, it was “retained by its holders; but nothing more than stability and confidence in the government is requisite to draw it into circulation.”53 He also observed that the interest rate for foreign debt “should strike us with shame,” and he warned prophetically that this debt would “one day endanger the peace of our country.”54

The Federalist Papers, which were enormously influential in securing ratification, emphasized the private capital that would flow from the Contract Clause.55 Newspapers engaged in “not a little discussion of the obli-

45. 4 Elliot's Debates, supra note 26, at 333–36.
46. Elliot's Debates, supra note 26, at 486.
47. See 4 Elliot's Debates, supra note 26, at 191 (North Carolina); 3 Elliot's Debates, supra note 26, at 478 (Virginia).
48. Elliot's Debates, supra note 26, at 143–44.
49. Id. at 188–89.
50. Id. at 189.
51. Id. at 366–67.
52. Id.
53. Id.
54. Id.
55. The Federalist No. 44 (James Madison); Beard, supra note 32, at 180.
gation of the contract clause . . . during the period of ratification . . . as an added safeguard" for investment.\textsuperscript{56} In this atmosphere, the Constitution was adopted.

E. CASE AUTHORITY INTERPRETING THE CONTRACT CLAUSE: FIDELITY TO ITS ECONOMIC PURPOSES

The early Contract Clause cases were authored by John Marshall, one of the delegates to the Convention and a strong believer in the economic function of the clause. He gave the following statement of its purposes:

We cannot look back to the history of the times when the august spectacle was exhibited of the assemblage of a whole people by their representatives in Convention . . . without being sensible of the great importance . . . attached to the tenth section of the first Article. The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man [and] touches the interest of all . . . had been used to such an excess by the State legislatures as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. The mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith. To guard against the continuance of the evil . . . was one of the important benefits expected from a reform of the government.\textsuperscript{57}

II. ULTIMATE PURPOSES: ECONOMICS OR FAIRNESS?

When a court considers a case involving one of the economic protections of the Constitution, it must decide whether the objective of the provision is economic in nature or whether it is to guarantee fairness.\textsuperscript{58} The attribution of the particular clause to one or the other of these policies makes a big difference. Offhand, it might seem that the affected person would be better treated by a fairness approach, but paradoxically, this is not the case. Economic interests are more seriously protected by an economic approach than an orientation toward fairness.\textsuperscript{59}

The Due Process Clause is the prototype of a provision with a fairness objective.\textsuperscript{60} This clause can be said to provide some degree of economic protection, since it protects "property" from deprivation without due process.\textsuperscript{61} But as every beginning student of constitutional law knows, the substantive protection that the Due Process Clause provides to economic

\textsuperscript{56}. BEARD, supra note 32, at 180.
\textsuperscript{59}. For an explanation of this principle, see id. at 23–25 (comparing fairness purposes as a basis of the Takings Clause with economic purposes, which provide greater security to investors).
\textsuperscript{60}. See, e.g., Mathews v. Eldridge, 424 U.S. 319, 343 (1976) (describing relevance of "fairness and reliability" to consideration of laws under the Due Process Clause).
\textsuperscript{61}. See U.S. CONST. amend. XIV.
activity is minimal. The state complies with the Due Process Clause if it can articulate a "rational basis" for its regulation, or if it can argue, even after enactment on the basis of considerations never advanced before, that its law economically disadvantaging the complaining citizen is "reasonably related" to a "legitimate state interest." A regulation that impairs economic interests is constitutional unless it is arbitrary. This standard is one of the lowest barriers to be found in constitutional doctrine.

The application of this standard to a regulation of contracts will usually allow the regulation to impair contracts. In other words, it will make the Contract Clause a dead letter. Imagine, for example, an investor whose foresight pays off and entitles him to a healthy gain. The investor's newfound wealth creates envy or resentment, however, in those who are not so fortunate, especially if their economic situation is such that it is the investor's gain that makes them less well-off. This perception of fairness is especially likely to prevail if the investor's gains are unpredictable in amount but turn out to create value in excess of non-investors' guesses; in other words, successful oil and gas operations or pharmaceutical development will often produce populist demands for relief from investors' expectations. It seems "fair," in those situations, to shave away some of the investor's gain and to restore it to those who otherwise would gain less from the transaction. Fairness, in other words, does not protect the investor's right to the benefit of the bargain. And if a court looks to the Due Process Clause, it will see that this clause does not affect a regulation that lessens the investor's gain in order to transfer wealth to those who otherwise would gain less, because there is a rational basis for the contractual impairment. The law may take something away from the investor, but it does so in a way reasonably related to a legitimate state purpose, because it helps to promote equality by giving back to the losers what they have contracted to pay.

An economic focus would view this case differently. Economic purposes are served by assuring the investor the gains received from the transaction. This outcome leads to investor confidence. As a result, it encourages investment, and it provides credit at more reasonable costs.

63. See id. at 572.
65. Cf. William H. Lash, Price Caps on Prescription Drugs is Bad Medicine, House Chronicle, Jan. 21, 2000, at 39A (describing efforts of the Clinton administration to impose price controls; arguing that controls would "dim economic incentives and kill innovation").
66. Cf. Williamson v. Lee Optical, 348 U.S. 483, 487–91 (1955) (using rational basis test to uphold a law imposing economic losses on some for benefit of others). "It is enough that there is an evil at hand for correction, and that it might be thought that the particular legislative measure was a rational way to correct it." Id.
67. See supra Part I.
The losers in the transaction can, if the democracy so desires, be assisted or even restored to neutral or even profitable outcomes through subsidies achieved by the tax-and-transfer system. Usually, this mechanism does not interfere with investor confidence, and it generally does not discourage investment or drive up interest rates. But as the preconstitutional history shows, there is a shortsighted tendency for legislatures to avoid the democratic effects of this course of action and instead achieve the result by impairing contracts. An economic interpretation of the Contract Clause would prohibit this solution.

There can be little question which of these two purposes the Founders had in mind when they adopted the Contract Clause. As the preceding Part of this Article shows, a philosophy of original intent would attribute an economic purpose to the clause: a policy of reassuring investors. The court decisions, however, are inconsistent. Sometimes the reasoning is that of fairness rather than economics. Sometimes, unfortunately, the courts have even cited Due Process Clause cases while interpreting the Contract Clause. This approach is counterproductive, because the Due Process Clause will usually uphold even the kinds of contract impairments that are the core concern of the Contract Clause. This is not to say that every retroactive regulation would be regarded as unconstitutional under an economic analysis. The point is only that investor protection is the proper focus, and if a particular lessening of the gains of a given investor is not of a kind that will decrease investor confidence generally, it is not unconstitutional under an economic approach. The point, therefore, is that a regulation of contract is judged consistently with the original intent if an economic purpose—a policy of investor protection—is the basis by which it is considered.

The structure of the Contract Clause that is created by its grammar and expression is fundamentally different from that of more flexible provisions such as the Due Process Clause. Due process requires a balancing process of some kind to determine its meaning, because it is not a categorical prohibition of denial of life, liberty, or property; it allows interference with autonomy if the interference is accomplished consistently with


69. Cf. id. (suggesting superiority of tax-and-transfer systems).

70. See supra Part I.

71. See id.


73. See supra notes 61–64 and accompanying text.

74. For example, see infra Part III.D, for an analysis of Texaco, Inc. v. Short, 454 U.S. 516 (1982), which upheld the destruction of contractually created interests but arguably was consistent with the original intent of the Contract Clause.

75. See Mathews v. Eldridge, 424 U.S. 319, 335 (1976) ("[D]ue process is flexible . . . ").
the "process that is due." The Contract Clause, on the other hand, is categorical, and it enacts a flat prohibition of contract impairment. Furthermore, the Due Process Clause is general in scope, applying to all regulations of whatever kind, whereas the Contract Clause is narrow and specific, applying only to contracts. This structure does not mean that the Contract Clause is absolute, but it does mean that it should be read differently from a provision expressing an explicit balancing.

III. COMPARING THE DECISIONS TO THE ORIGINAL INTENT

Some of the judicial decisions are consistent with the original intent, some are not, and some are in between. Decisions that result in impairing contracts, it should be added, are not uniformly contrary to the Founders' purpose. The issue is whether the decisions adequately protect investors. If a particular outcome does not threaten investor confidence even though it contravenes contractual expectations, it may be consistent with the original intent. Also, no clause of the Constitution is absolute, and the Contract Clause needs to be read in context.

Some of the early decisions fail in obvious ways to carry out the Founder's intentions. A holding that no state can surrender its power over the welfare of its citizens, for example, is contrary to the original intent, because if there is a change of law from a position allowing a given contract to a position impairing it, the change may very well be defensible as a protection of citizen welfare, but it also may undermine investor confidence. Other decisions are not so easy to characterize.

A. HOME BUILDING & LOAN ASSOCIATION v. BLAISDELL: FORECLOSURE MORATORIA IN RESPONSE TO A DEPRESSION

In Home Building & Loan Association v. Blaisdell, the state's regulation responded to the Great Depression. It retroactively enacted a moratorium on mortgage foreclosures. This enactment ostensibly impaired contract expectations, because it meant that a mortgagee who had obtained the agreement of a mortgagor to mortgage foreclosure under defined conditions could not lawfully foreclose, in spite of the existence of the conditions that the parties had agreed would permit foreclosure. It is possible to read Blaisdell as inconsistent with investor protection. An
investor who perceives the possibility that such a moratorium may be
lawfully imposed will correctly see that the investor autonomy created by
the contract arrangement is impaired. The enactment at issue in Blaisdell,
therefore, leaves the investor with less than was contracted for, and it
does so after the contract has become operational and the investor has
run the risks of the contract.83

But perhaps there is another way to view the moratorium. As enacted,
it responded to a situation in which many, if not most, debtors were un-
able to pay according to their contracts.84 The moratorium did not extin-
guish any debt; it merely delayed the requirement of its payment.85
Furthermore, the delay was temporary and limited to what was seen as
necessary to provide for the possibility of payment.86 It is conceivable, in
such a situation, that a moratorium may protect investors generally, as
opposed to individual investors, by enhancing the probability that repay-
ment will become more likely, or at least that foreclosure sale prices may
rise, by reason of a delay that puts the possibility of sale into another time
when economic conditions may not be so bad. Without a moratorium, the
strategy of individual investors will be to foreclose as early as is feasible,
and this strategy conceivably benefits a few who act quickly and force-
fully, but it may disadvantage the many who act more cautiously or who,
for whatever reason, are unable to foreclose early—including those
whose debtors are more financially able to respond and those who work
with their debtors. By this reasoning, the Blaisdell decision does not un-
dermine investor confidence and is consistent with the original intent. On
the other hand, it is possible that a moratorium of this kind will not have
beneficial effects, or that it will result in a wealth transfer from investors
to borrowers. This possibility indicates a way to reach the conclusion that
Blaisdell is inconsistent with the original intent.

In summary, someone keeping a box score that evaluates achievement
of the original intent by different decisions will have to consider Blaisdell
carefully. It is somewhere in the middle. Probably, the evaluation de-
pends upon how predictably faithful the Blaisdell criteria will induce the
courts to be, in considering whether a particular contract interference im-
pairs investor confidence. If Blaisdell results in a regime in which inves-
tors foresee that courts will surrender to populist demands for contract
impairment, the decision will contravene the original intent. If, on the
other hand, investors perceive the Blaisdell criteria as leading the courts
to allow moratoria only rarely, and only in situations in which arguments
indicate that advantages to nearly all are likely to follow, including for
most investors, then the decision will be consistent with the original
intent.

83. Id. at 423.
84. Id. at 421–24.
85. Id. at 425.
86. Id.
B. Allied Structural Steel Company v. Spannaus: Retroactive Changing of Pension Obligations

The Allied decision applied the Blaisdell decision in a way that seemed to promise something of a return to the original intent, even if not perfectly so. The regulation in question had retroactively altered the pension obligations of some employers by requiring them to fund larger payments than they had agreed to make. The Court included a statement of the purpose of the Contract Clause, and its expression correctly reflected the original intent by saying that the policy was one of protecting reliance interests in personal and business affairs. Its treatment of the state statute at issue arguably carried out this purpose.

The Court set up a two-stage method for Contract Clause analysis that endures to this day, even though arguably it has at times been misinterpreted. The first question, said the Court, was whether there was a "severe" impairment of contract. The severity of an impairment was to be viewed from the standpoint of the complaining contracting party, or in other words, as the interference would be viewed by an investor. If the impairment was not severe, the Constitution apparently would not help the investor; non-severe impairments were to be tolerated. If the impairment was severe, the second stage was more complex. Then, the Court was to consider five factors that the Court saw as important to the Blaisdell decision. These criteria included, first, a legislative finding of an emergency; second, a legislative purpose to "protect a basic societal interest [rather than] a favored group"; third, "relief [that] was appropriately tailored to the emergency that it was designed to meet"; fourth, "conditions [that] were reasonable"; and fifth, a duration limited to the time of the emergency.

The Court concluded, first, that the impairment was severe. It did so partly by considering the absolute amount of the additional dollars that the company would be required to spend, as well as considering the extent to which the change upset the company's expectations. Second, the enactment failed to conform to the Blaisdell factors. There was no showing of an emergency, and there was no general social problem to which the law was directed, because the enactment merely increased the

88. Id. at 236–39.
89. Id. at 245.
90. Id. at 244–47 (describing the first stage); id. at 247–50 (describing the multi-factor second stage).
91. See, e.g., discussion infra Part III.C. (analyzing the Energy Reserves Group case).
92. See Allied, 438 U.S. at 244.
93. See id. at 246–47 (analyzing severity by unexpected impact on the company).
94. See id. at 245.
95. Id. at 242.
96. Id.
97. Id. at 246.
98. Id. at 246–47.
99. Id. at 248–49.
amounts owed to certain select employees. It was sudden, unanticipated, and difficult to plan for; this factor apparently demonstrated to the Court a lack of tailoring to the conditions the law was designed to address. It did not operate in an area of economic endeavor that was already heavily regulated, and the Court evidently considered this feature in evaluating the reasonableness of the law. Finally, it was not temporary or limited in duration to the time of any emergency.

This decision brought the Allied-Blaisdell criteria to greater consistency with the original intent of the Contract Clause than had existed after Blaisdell alone. The Court made a point of adding that the Contract Clause “remains part of the Constitution. It is not a dead letter,” although it had been widely viewed as that during the time between Blaisdell and Allied. But the Court’s conformity to the original intent was incomplete. In terms of its rhetoric, the opinion emphasized that the Contract Clause did not “obliterate the police powers of the States,” a statement that, in context, seemed to encourage contract impairments. And the opinion introduced its discussion of the Blaisdell factors with the relatively weak endorsement that the clause “must be understood to impose some limits upon the power of a State.” In terms of its principal holding, the two-stage analysis provided enough ambiguity to allow the upholding even of a contract impairment that seriously undermined investor confidence by a court that happened to be so inclined. The “severity” of a contract impairment is in the eye of the beholder, and the five second-stage criteria are manipulable.

C. Energy Reserves Group v. Kansas Power & Light Company: Denying Investors the Benefit of Their Bargain

If Allied had signaled a Renaissance of the earlier dead letter of the Contract Clause, Energy Reserves Group effected a reburial. The investors whose contracts were impaired were natural gas producers whose contracts with a utility company contained escalation clauses that increased prices along with rising markets, clauses that were widely, if

100. Id. at 248–50.
101. Id. at 249–50.
102. Id.
103. Id. at 250.
104. Id. at 241.
105. See id. at 241 & n.12 (quoting a commentary to the effect that during that time period, results would be the same if the Contract Clause “were dropped out of the Constitution”).
106. Id. at 241.
107. Id. at 242.
108. See id. at 246–48.
110. Id. at 403–05.
not universally, parts of natural gas contracts. The contracts at issue were made for sales within the intrastate market, covering only gas produced in Kansas and sold in Kansas. This inside-the-state aspect of the contracts was important, because although the federal government regulated interstate sales of gas according to a complicated system that suppressed prices, it did not regulate intrastate prices during the time period at issue. The intrastate market was a favorite of investors because it reflected market prices more accurately, and likewise, it was a favorite of consumers because the operation of market forces meant adequate supply with fewer interruptions than the interstate market had experienced. Nevertheless, in response to rising prices, the Kansas legislature enacted the Kansas Natural Gas Price Protection Act, which limited the operation of escalation clauses in producers' contracts with buyers.

The Supreme Court upheld the Act. The Court avoided direct analysis of the first Allied-Blaisdell issue by saying that although Energy Reserves Group could have anticipated the possibility of federal regulatory changes that occurred, it could not have expected the magnitude of the higher prices that its price escalators would produce. This observation seems odd, since that was the purpose of the escalators. The Court transitioned to the second stage by observing that "[t]o the extent, if any, [that] the Kansas Act impairs ERG's contractual interests," it was justified by countervailing interests. It ignored the criterion of an "emergency," saying only that the Act would cause "hardship." The "tailoring" criterion also underwent reinterpretation, with the Court saying, instead, that the means chosen to implement the Act were not "deficient." The Court conceded that prices in the interstate market had never been regulated, and this fact should have made the Court consider, as in Allied, whether the new regulation was unanticipated; but the Court sidestepped that conclusion by saying that the state had regulated gas production in

111. See generally David Crump, Natural Gas Price Escalation Clauses: A Legal and Economic Analysis, 70 MINN. L. REV. 61 (1985) (describing and analyzing these clauses, which "usually" appear in these contracts).
112. See Energy Reserves Grp., 459 U.S. at 408 (indicating that the subject was intrastate gas).
113. See Crump, supra note 111, at 68-75 (describing the federal regulatory system).
114. The Natural Gas Policy Act extended federal price controls to the intrastate market in 1978, but the sales at issue remained unregulated by federal authorities because they had been contracted before that time. Energy Reserves Grp., 459 U.S. at 406-07.
115. Id. at 414 & n.19 (describing how gas tended to be "diverted to the intrastate market" because buyers "were willing to pay higher prices." Stripped of its pejorative rhetoric, this verbiage means that both producers and consumers preferred pricing set by market forces rather than by regulations forcing it below market so that supply met demand and shortages were avoided.).
116. Id. at 407.
117. Id. at 415-16.
118. Id. at 416-17.
119. Id. at 417.
120. Id. at 418.
other ways. Finally, the Court did not consider whether the Act was limited in duration to any emergency, but instead, it said that the effects of the Act would decrease in tandem with federal regulations, which were of uncertain duration.

Energy Reserves Group is inconsistent with the original intent. The Court implicitly assumed that the price impairment to investors was trivial, or that there was something about price escalation that was unimportant to them. On the contrary, price escalation clauses were virtually universal in gas contracts, and they were heavily negotiated. Producers who sold gas on long-term contracts traded later escalation, in effect, for lower initial prices. If prices were to be uniform throughout the term of a twenty-year contract, a rational producer would insist on a very high price in the first years. The Court's application of the Allied-Blaisdell factors was not faithful to those decisions, and it shows how incompletely Allied conformed to the original intent.

D. Other Cases: Mixed Results in Serving the Original Intent

In Texaco Inc. v. Short, the Supreme Court upheld the Indiana Dormant Mineral Interests Act. This law provided that an undeveloped severed mineral estate (such as an oil and gas interest that was owned by someone who did not own the surface) would lapse after twenty years unless preserved by certain publicly filed documents. Thus, the mineral estate would disappear, because it would be merged with the surface estate. The motivation for the Act was prevention of the fragmentation of estates by transfers or inheritances, which caused small estate interests to proliferate, and in turn impeded development as well as administration by producers who paid royalties. The owner of a lapsed estate filed suit on the claim that the Act impaired the contract for purchase of the estate.

Paradoxically, this decision seems consistent with the original purpose of the Contract Clause, even though it resulted in the complete loss of the property right created by the impaired contract. A focus upon the protection of investors reduces the apparent paradox. An investor would be unlikely to seek to acquire an ordinary mineral estate in the first place if the investor had no intention of developing it within twenty years, because the present value of production more than twenty years from now

121. Id. at 413–14.
122. Id. at 418.
123. See Crump, supra note 111, at 61–63 and cited authority.
125. See generally Crump, supra note 111, at 75–76 (explaining this tradeoff).
127. Id. at 518–19.
128. Id. at 541.
129. Id. at 523.
130. Id. at 522–23.
probably would be small in relation to the present investment.\textsuperscript{131} For the unusual transaction in which an investor might do so, the investment could be protected easily by the filing of a document. It seems unlikely that these consequences would discourage purchasers of mineral estates.

On the other hand, \textit{United States Trust Company of New York v. New Jersey} involved the states' impairments of their own contracts.\textsuperscript{132} U.S. Trust Company sued as a trustee and holder of New York Port Authority Bonds, on the ground that state statutes passed by New York and New Jersey impaired the contracted-for security for the bonds, which had been arranged by the contract of sale of the bonds.\textsuperscript{133} As part of the bond transaction, the two states had set up a covenant limiting the power of the Port Authority to use revenues to subsidize passenger transportation.\textsuperscript{134} The statutes at issue repealed this covenant and authorized use of revenues for passenger subsidies, thus reducing their availability to secure the bonds.\textsuperscript{135} The Court held that the statutes violated the Contract Clause because the states' promise was "purely financial and thus not necessarily a compromise of the State's reserved powers."\textsuperscript{136}

\textit{United States Trust} was decided before \textit{Allied}, and it did not rely on the \textit{Allied-Blaisdell} factors. Its primary meaning seems to be that the state cannot easily abrogate its own contracts, at least not financially related contracts, as opposed to contracts between private persons.\textsuperscript{137} But the Contract Clause was motivated by preferences for in-state citizens, not merely contracts made between citizens and states.\textsuperscript{138} The decision contains the usual recognition of the police power of the state, and it distinguishes contracts involving taxing and spending powers, which the states effectively can agree to, and contracts impairing the police or eminent-domain powers, which it says are "invalid ab initio."\textsuperscript{139} \textit{United States Trust} therefore adds to the protection of investors only in a limited area. It did, however, provide an introduction to the subject that may have helped persuade the Court to consider the \textit{Allied} case.

\section*{IV. CURRENT CASES}

The Contract Clause continues to be an important source of disputes, including disputes of major proportions: disputes that affect many people and institutions. But the recent cases do not always consider the purpose of the clause. This is unfortunate, because the original intent could be an

\begin{enumerate}
\item \textsuperscript{131} Cf. \textsc{Crump}, \textit{supra} note 68, at 165 (explaining finance theory of present value of future payments by an example: a \$50,000 payment twenty years from today is worth only \$7,432, not \$50,000, assuming a 10 percent rate of return).
\item \textsuperscript{132} See 431 U.S. 1 (1977).
\item \textsuperscript{133} \textit{Id.} at 3–8.
\item \textsuperscript{134} \textit{Id.} at 9–11.
\item \textsuperscript{135} \textit{Id.} at 12–14.
\item \textsuperscript{136} \textit{Id.} at 25.
\item \textsuperscript{137} Cf. \textit{id.} at 23–24 (suggesting a difference between public and private contracts, so that the state's own contract is harder for it to abrogate, at least for financial reasons).
\item \textsuperscript{138} See \textit{supra} Part I.B–D.
\item \textsuperscript{139} \textit{U.S. Trust}, 431 U.S. at 23–24.
\end{enumerate}
important aid to interpretation of the clause in some of these cases, and the Supreme Court's past decisions have used and even emphasized it.

A. United Automobile, Aerospace, [and] Agricultural Implement Workers v. Fortuno: Does Abrogating a Public Employee Union Agreement Violate the Contract Clause?

In United Automobile Workers, national and local labor unions as well as public-employee members of unions brought an action against the governor of Puerto Rico, alleging that a legislative enactment to deal with an economic crisis violated the Contract Clause, among other constitutional provisions. The enactment was entitled the "Law Declaring a Fiscal State of Emergency and Establishing a Comprehensive Fiscal Stabilization Plan to Save Puerto Rico Credit." Among its provisions was a plan to reduce the government payroll. Phase One of this plan was "a 'permanent workday reduction program' for certain senior employees," coupled with incentives for voluntary resignations. Phase Two, which was conditioned upon a failure of Phase One to produce complete success, would include involuntary layoffs. Phase Three suspended a variety of "statutory, contractual, and other provisions governing" working conditions of public employees, including provisions of collective-bargaining agreements that covered pay, promotion, demotion, work force reductions, and other aspects of public positions.

The court upheld the dismissal of the complaint. This aspect of the case makes analysis difficult, because the holding purported to be based upon an inadequacy of the allegations in the complaint, although it obviously was nonetheless a ruling on the merits of the Contract Clause issue. Without considering what the Allied opinion had said about the purpose of the Contract Clause, the court applied the five Allied-Blaisdell factors in the second stage of the analysis under those decisions. The opinion assumes, without deciding, that the impairment of contract rights was substantial, so that the five criteria of the second stage were the deciding factors. The allegations of the complaint, said the court, did not establish that there was no "important governmental purpose" supporting the enactment. Furthermore, the allegations did not contradict Pu-
erto Rico’s assertion of the “reasonableness and necessity” of the law.\textsuperscript{151}

This approach, said the court, would not inhibit meritorious Contract Clause claims.\textsuperscript{152} A plaintiff asserting that there was a lack of an important government purpose could allege facts showing that the impact of the enactment was limited and of assistance only to a select few.\textsuperscript{153} A plaintiff asserting that the law was not reasonable or necessary could allege facts showing that it “did not save the state much money, [that] the budgetary issues were not as severe as alleged by the state, or that other cost-cutting or revenue-increasing measures were reasonable alternatives to the contractual impairment at issue.”\textsuperscript{154}

This analysis, unfortunately, fails to protect the purposes of the Contract Clause, even though the result is defensible. The court watered down the \textit{Allied-Blaisdell} factors in ways that made them barely recognizable and much easier for an overreaching state to satisfy. An “important public purpose” is a far lesser requirement than an “emergency,” which is what \textit{Allied} and \textit{Blaisdell} suggested was required,\textsuperscript{155} as well as what Puerto Rico asserted.\textsuperscript{156} “Reasonableness and necessity” are aspects of the \textit{Allied-Blaisdell} factors, but they are supplemented in those decisions by requirements of tailoring and temporary duration,\textsuperscript{157} which the \textit{Automobile Workers} court did not emphasize.

Perhaps the court could have reached the same result by considering whether the contracts at issue were of the kind that the Contract Clause was intended to protect; and, if it had done so, it could have minimized the damage its holding might do to the original purpose. If investor protection is the object of the Contract Clause, it seems unlikely that the union contracts at issue in \textit{Automobile Workers} were the kind of agreements that meet that concern. The clause was designed to call forth capital, to reassure investors, and to provide credit at reasonable rates.\textsuperscript{158} These, actually, were the objectives of the Puerto Rican law that the plaintiffs attacked.\textsuperscript{159} Perhaps the unions could have wedged their claims into the purpose of the clause by pointing out that public employees work for present and future job security, and thus are a type of investors, but this argument seems quite different from the intentions of the Founders. The \textit{Automobile Workers} court could also have followed the \textit{Allied-Blaisdell} criteria more faithfully by enumerating the five factors as those decisions did, but coupling this approach with an analysis based on the original intent of the Contract Clause would have further improved the court’s analysis.

\textsuperscript{151} See \textit{id.} at 45–47.  
\textsuperscript{152} \textit{Id.} at 45.  
\textsuperscript{153} \textit{Id.}  
\textsuperscript{154} \textit{Id.}  
\textsuperscript{155} See supra Part III.B.  
\textsuperscript{156} See supra note 141 and accompanying text.  
\textsuperscript{157} See supra Part III.B.  
\textsuperscript{158} See supra Part I; see also supra note 14 (citing Supreme Court recognition of these purposes).  
\textsuperscript{159} See supra notes 139–40 and accompanying text.
B. **NEW JERSEY RETAIL MERCHANTS ASSOCIATION v. SIDAMON-ERISTOFF: DOES RETROACTIVE ESCHEAT OF UNCLAIMED GIFT CARD BALANCES VIOLATE THE CONTRACT CLAUSE?**

In *New Jersey Retail Merchants*, the court held that retroactive escheat of unclaimed balances in “stored value” cards, or gift cards, violated the Contract Clause when it contradicted the agreements of issuers and cardholders.\(^{160}\) The principal issue concerned unused gift cards, for which the new law required issuers to pay over unclaimed cash to the state.\(^{161}\) This feature of the enactment meant that issuers had to turn over the value of the gift certificates in cash, when they were originally bound to turn over only merchandise or services to the owner.\(^{162}\) Merchants thus lost income that they otherwise would have earned, in the amount by which the cash charged for their goods and services exceeded the cost of those goods and services.\(^{163}\) In other words, they lost the profit that a merchant earns that they had bargained for with customers.\(^{164}\)

The court’s analysis followed the *Allied-Blaisdell* pattern generally. First, the court held that the impairment was “substantial,” in response to the threshold inquiry required by *Allied*.\(^{165}\) The court held that this standard required determination of “the legitimate expectations of the contracting parties.”\(^{166}\) Issuers “expected to realize a profit when the bearer redeemed the card for the Issuers’ merchandise or services.”\(^{167}\) But requiring issuers to turn over the entire abandoned cash balance “effectively transfers their expected benefits to state custody.”\(^{168}\) This unexpected obligation substantially impaired the issuers’ contract rights.\(^{169}\)

The court then considered the second stage of the *Allied-Blaisdell* inquiry.\(^{170}\) Although not a response to emergency, the state’s enactment did serve “a significant and legitimate public purpose” that was not narrowly focused, because “[s]tate escheat law works to remedy the ‘broad and general social . . . problem’ of reuniting abandoned property with its owners.”\(^{171}\) But the enactment was not appropriately limited or tailored, as the *Allied* criteria had held that it must be. “Serving the State’s public purpose of reuniting abandoned property with owners did not require the

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161. *Id.* at 383–84.
162. *Id.*
163. *Id.* at 387.
164. *Id.* at 386–87.
165. *Id.* at 386.
166. *Id.* at 386 (quoting U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 19 n.17 (1977)).
167. *Id.* 386–87.
168. *Id.* at 387.
169. *Id.*
170. *Id.*
State to entirely deprive [card] Issuers of this bargained-for benefit.”

Instead, “[l]ike many other states that escheat gift cards, New Jersey could have accommodated the Issuers’ expectations by requiring them to turn over a percentage of the value of the abandoned gift card, reflecting a discount based on the expected profit or merchant fee, rather than the card’s entire remaining value.”

A focus on the original intent underlying the Contract Clause would have clarified the basis of the court’s opinion. The court sensibly evaluated the legitimate expectations of the contracting parties, but the court did not indicate how this issue related to the constitutional provision. Undermining the legitimate expectations of contracting parties brings about the precise disadvantages that the Contract Clause was intended to avoid. It defeats the policy of assuring investors of the benefit of their bargains so as to call forth capital accumulation and provide for reasonable costs of credit.

The court’s holding and reasoning were generally consistent with these purposes, but surer enforcement of the Contract Clause, as well as avoidance of its misapplication, would follow from recognizing its purposes.

V. CONCLUSION

The original intent underlying the Contract Clause emerges unmistakably from the constitutional history. The clause is an economic provision, designed to protect investors. It is intended to encourage capital formation and avoid excessive costs of credit. It is not a protection of minority rights as such, nor is it a guarantee of a general kind of fairness. In fact, a fairness reading would minimize the effect of the clause by upholding contract impairments that could somehow be defended, even arguably, as fair. When an investor has succeeded in earning a significant return, it may seem fair to shave part of that return away and give it to consumers or the public generally, as the courts sometimes have done. But this kind of fairness would undermine investor confidence. The Founders inferred that such an approach would tend to discourage capital investment and drive up costs of credit, and it was these effects that they intended to prevent.

The Allied-Blaisdell criteria tend to serve this original intent of the Founders, at least if the courts apply them rigorously. The Allied opinion, in fact, supports its derivation of its two-step approach and its five second-stage factors by explicitly citing the original purpose and molding its standard to serve that purpose. In some of the decisions, however, the courts have misapplied the Allied-Blaisdell criteria or have watered them down.

The Contract Clause continues to arise in major litigation, often in contexts differing from those of earlier decisions that provide only ambigu-

172. Id. at 388.
173. Id.
174. See supra Part I.
ous guidance, and consideration of the original intent would provide more consistent results in these varying situations. Furthermore, an express recognition of the economic purpose of the Contract Clause, with its policy of investor protection, would help the courts to apply the clause according to its objective, while at the same time avoiding its application to cases that it was not designed to fit.