Municipal Bonds and the Contract Clause: Looking Beyond *United States Trust Company v. New Jersey*

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Introduction

For the first time in over a generation, the security of municipal bonds is in doubt. Throughout the post-World War II era and until recent years, the debt obligations of state and local governments have been regarded as among the most secure of all investments. The mid-1970's, however, have witnessed defaults and near-defaults on municipal bonds to an extent not encountered since the Great Depression.

Most notable has been the financial difficulty of New York City, which has been on the brink of default on several occasions during recent years. On one such occasion, the city was saved from default only by a legislatively-declared moratorium on payment of principal and interest on several of its outstanding obligations.[1] This moratorium was later held unconstitutional by the New York Court of Appeals.[2] In addition to New York City's financial difficulties, several special purpose governmental units of New York state,[3] and even the state itself,[4] have been in danger of insolvency from time to time during the last several years. Less notable, but almost as serious, have been the financial difficulties of several other large cities, including Boston,[5] Philadelphia,[6] Detroit,[7] Cleveland[8] and Yonkers.[9] While

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1. 1975 N.Y. Laws, ch. 874, *as amended by* 1975 N.Y. Laws, ch. 875. *See generally* Shalala & Bellamy, *A State Saves a City*, 1976 DUKE L.J. 1119.

2. Flushing Nat'l Bank v. Municipal Assistance Corp., 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

3. *See, e.g.*, Wall St. J., Feb. 25, 1975, at 28, col. 3 (New York Urban Development Corporation); *id.*, Nov. 11, 1974, at 19, col. 2 (New York Mortgage Finance Agency).

4. *See, e.g., id.*, June 2, 1975, at 16, col. 1.

5. *See, e.g., id.*, Apr. 15, 1977, at 1, col. 1.

6. *See, e.g., id.*, Jan. 20, 1976, at 31, col. 3. *See also id.*, Feb. 3, 1976, at 29, col. 2 (Pennsylvania Housing Finance Agency).

7. *See, e.g., id.*, Mar. 25, 1976, at 25, col. 1.

8. *See, e.g., id.*, June 19, 1975, at 1, col. 6; *id.*, May 27, 1976, at 32, col. 1.

9. *See, e.g., id.*, Dec. 15, 1975, at 7, col. 1.

default is not yet a serious threat for any of these municipalities, each has, on occasion, found the money markets closed to it because of investor concern about the soundness of its financial affairs.

These problems seem likely to continue, if not to intensify, over the next decade.[10] Many of the cities currently in financial difficulty face the prospect of continuing increases in maintenance and service costs which are, to a large extent, uncontrollable. This, coupled with a declining tax base and tax rates which cannot be further increased without driving even more industries out of the city, ensure that the financial problems of municipalities will continue. Furthermore, at the same time that revenue sources are becoming static or declining, the cities are facing increasing pressures to become involved in such deficit-generating activities as mass transit, welfare and urban renewal. Only with greatly increased federal and state aid, which seems unlikely to materialize, can many older cities avoid the threat of insolvency.

These strains on the finances of state and local governmental entities are likely to place growing pressures on state legislatures to enact laws detrimental to the interests of the bondholders and other creditors of such entities. In drastic situations, where the emergency is extreme and immediate legislative action is required to stave off pending bankruptcy, such laws are likely to take the form of a primary impairment of the bondholders' rights, such as suspension of the right to collect interest or principal payments when due. More often, however, the proposed legislation is likely to take the form of a secondary impairment of the bondholders' rights, such as dilution of the security for payment of the obligations or modification of the bondholders' remedies.[11] While such secondary impairments may have no immediate effect on the bondholders' rights, in the long run their effects may be no less drastic than that of legislation which creates a primary impairment. In fact, the latter type of legislation may be the more deleterious of the two and may constitute the most serious threat to the stability of the market for municipal debt obligations. Nevertheless, since such laws may have no immediate effect on the bondholders' receipt of timely payments of interest and principal, they may be more politically palatable and thus easier to enact. In contrast, legislation immediately suspending or otherwise abridging the bondholders' right to receive timely payments of principal and interest is likely to be politically acceptable only in periods of dire emergency.

10. *See generally* Blaydon & Gilford, *Financing the Cities*, 1976 DUKE L.J. 1057; Wall St. J., Sept. 30, 1976, at 10, col. 2.

11. *See, e.g.*, W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935); Louisiana v. Pilsbury, 105 U.S. 278 (1882); Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535 (1867).

In this context, the Supreme Court's decision in *United States Trust Company v. New Jersey*[12] is one of the most significant opinions handed down during its 1976 term. In an apparent reversal of the trend established by several earlier decisions,[13] the Court held that the New Jersey legislature's repeal of a covenant protecting bondholders of the Port Authority of New York and New Jersey violated the contract clause of the United States Constitution.[14] The balance of this paper will analyze this opinion and attempt to assess its significance in the context of the Court's development and interpretation of that clause.

I. The *United States Trust* Case

A. The Facts

The Port Authority of New York and New Jersey is an agency that was established by both states in 1921 in order to effectuate "a better coordination of the terminal, transportation and other facilities of commerce in, about and through the port of New York."[15] The Authority possesses no taxing power and is unable to pledge the credit of either state.[16] Thus, from the outset, it has had to rely on loans from private investors and the revenues generated by its own activities in order to finance its operations.

The Authority has proved to be highly successful financially; in addition to activities connected with the Port of New York, its operation of the tunnels and bridges spanning the Hudson River proved to be highly lucrative.[17] This was due largely to the policy followed by the directors of the Authority, which required that each project it undertook should be self-supporting.[18] Because the Port Authority was dependent not only on revenues generated from its own activities but also the willingness of investors to subscribe to its debt obligations, it was especially solicitous in protecting the interests of those investors. In 1930, legislation was passed by both states creating a General Reserve Fund from all surplus revenues derived by the

12. 431 U.S. 1 (1977).

13. *See* City of El Paso v. Simmons, 379 U.S. 497 (1965); Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934).

14. 431 U.S. at 32.

15. 1921 N.J. Laws, ch. 151, p. 143; 1921 N.Y. Laws, ch. 154, p. 492. The consent of Congress to each and every article of this interstate compact was obtained, effective August 23, 1921. PUB. RES. No. 17, ch. 77, 42 Stat. 174 (1921).

16. 1921 N.J. Laws, ch. 151, art VII; 1921 N.Y. Laws, ch. 154, art. VII.

17. *See generally* Goldstein, *An Authority in Action—An Account of the Port of New York Authority and Its Recent Activities*, 26 L. & CONTEMP. PROB. 715, 717 (1961).

18. United States Trust Co. v. State, 134 N.J. Super. 124, 140, 338 A.2d 833, 841 (1975), *aff'd per curiam*, 69 N.J. 253, 353 A.2d 514 (1976), *rev'd sub nom.* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977).

Authority in an amount equal to ten percent of the par value of all outstanding bonds, and pledging this fund as security for those bonds then or thereafter issued by the Authority.[19] Surplus funds in excess of the ten percent requirement were available for use by the Authority in any manner authorized.

Another significant protection adopted for the benefit of bondholders was the so-called "1.3 test." This was first utilized in 1952, when the Authority began to issue "consolidated bonds" secured by all revenues generated by its operations, rather than by the revenues generated by a specific project. The 1.3 test

> prohibits the issuance of new consolidated bonds unless the best one-year net revenues of all of the Port Authority's facilities equal or are greater than 1.3 times the prospective debt service for the calendar year during which the debt service of all outstanding and proposed new bonds secured by a pledge of the general reserve fund would be at a maximum. The 1.3 test is thus an equation in which one component consists of the Authority's net revenues from all facilities, and the other component is the maximum annual debt service required to be paid on all Authority bonds, including the new bonds to be issued. The maximum annual debt service component is readily calculable from the requirements set forth in the bond issues.[20]

In addition, section seven of the Consolidated Bond Resolution prohibited the issuance of additional bonds secured by the General Reserve Fund unless the Authority certified that, in its opinion, the issuance of additional bonds would not materially impair its sound credit standing or the investment status of the consolidated bonds during the ensuing decade.[21]

Attempts to involve the Port Authority in mass transit activities date back at least as far as 1927.[22] Serious efforts in this direction did not commence until the late 1950's, however, following the bankruptcy of the Hudson and Manhattan Railroad, a commuter line that linked Manhattan with the New Jersey suburbs.[23] In 1958, the commissioners of the Port Authority testified that no plan that would involve the Authority in deficit-ridden mass rail transit activities would be acceptable unless it included some sort of protection for existing bondholders. Absent such protection, it was asserted that any additional bonds issued by the Authority would become unmarketable.[24] In 1961, the New York Legislature passed a measure providing for the operation of the Hudson and Manhattan by the Port

19. 1931 N.J. Laws, ch. 5; 1931 N.Y. Laws, ch. 4.
20. 134 N.J. Super. at 144, 338 A.2d at 843.
21. *Id.* at 145-46, 338 A.2d at 845.
22. *See id.* at 149, 338 A.2d at 846.
23. *Id.* at 150, 338 A.2d at 847.
24. *Id.* at 150-51, 338 A.2d at 849-52.

Authority, but the bill contained no covenant protecting creditors, and the New Jersey Legislature failed to pass reciprocal legislation for that reason.[25] In 1962, both legislatures did pass an enactment authorizing the Port Authority to acquire the Hudson and Manhattan; the law also contained the covenant in question in the present case, which limited Port Authority financial involvement.[26] The covenant effectively precluded the Authority from acquiring any mass transit facilities other than the Hudson and Manhattan, since such facilities would almost surely be plagued by substantial deficits that were forbidden by the carefully drawn terms of the covenant.[27]

25. *Id.* at 151-53, 338 A.2d at 848-49.

26. 1961 N.J. Laws, ch. 8, § 6 (repealed 1974); 1962 N.Y. Laws, ch. 209, § 6, *as amended by* 1972 N.Y. Laws, ch. 1003, § 1 (repealed 1974). A constitutional challenge to this legislation was initiated but proved unsuccessful, because the New York Court of Appeals asserted that the 1962 law clearly fell within the Congressional consent given in 1921. *See* note 15 *supra*. Courtesy Sandwich Shop v. Port of New York Auth., 12 N.Y.2d 379, 391, 190 N.E.2d 402, 406, 240 N.Y.S.2d 1, 7 (1963), *appeal dismissed*, 375 U.S. 78 (1963). *See also* Port Auth. Bondholders Protective Comm'n v. Port of New York Auth., 387 F.2d 259, 262 (2d Cir. 1967); Kheel v. Port of New York Auth., 331 F. Supp. 118, 120 n.3 (S.D.N.Y. 1971), *aff'd on other grounds*, 457 F.2d 46 (2d Cir.), *cert. denied*, 409 U.S. 983 (1972).

27. The relevant part of the covenant reads as follows:

> The 2 states covenant and agree with each other and with the holders of any affected bonds, as hereinafter defined, that so long as any of such bonds remain outstanding and unpaid and the holders thereof shall not have given their consent . . . (b) neither the States nor the Port Authority, nor any subsidiary corporation incorporated for any of the purposes of this act will apply any of the rentals, tolls, fares, fees, charges, revenues or reserves, which have been or shall be pledged in whole or in part as security for such bonds, for any railroad purposes whatsoever other than permitted purposes hereinafter set forth.

Consolidated Bond Resolution, § 6, *quoted in* United States Trust Co. v. State, 134 N.J. Super. 124, 161, 338 A.2d 833, 854 (1975) *aff'd per curiam*, 69 N.J. 253, 353 A.2d 514 (1976), *rev'd. sub nom.* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977).

The "permitted purposes" definition included (in addition to Hudson & Manhattan) only (1) those passenger railroad facilites which the Port Authority certified were "self-supporting" or (2) those not so certified, but only if the Port Authority stipulated that at the end of the preceding calendar year the General Reserve Fund contained the prescribed statutory amount (10% of all outstanding Authority bonds) and that all of the Authority's passenger railroad revenues, including those of any proposed acquisition, would not produce deficits in excess of "permitted deficits" as defined in the covenant. *See* 134 N.J. Super. at 161-62, 338 A.2d at 854. The term "self-supporting" referred to a facility where the "estimated average annual net operating income for the next ten years of operations is at least equal to the estimated average annual debt service on bonds issued in connection with the facility." *Id.* at 162, 338 A.2d at 855. The term "permitted deficit" meant

> a deficit which does not exceed (A) the amount of the passenger railroad deficit the payment of which one or both states is willing to guarantee for the period for which the Authority would be liable for such deficit, plus (B) the greater of (1) an amount equal to 10% of the general reserve fund at the end of the preceding calendar year less an amount equal to 1% of the Authority's bonds outstanding at the end of the preceding calendar year which were issued for passenger rail purposes (including the H & M), or (2) an amount equal to 10% of the amount calculated under clause (1) plus 1% of the Authority's equity in all facilites other than passenger rail facilities.

Subsequently, the Hudson & Manhattan Railroad was acquired by the Authority through its wholly owned subsidiary, Port Authority Trans-Hudson Corporation (PATH). Its operation proved to be even more unprofitable than had been originally forecast. Its accumulated operating deficits totalled $125,000,000 at the time the suit in question was commenced.[28] Nonetheless, pressures developed for further expansion of the PATH system. In 1973, bi-state legislation was passed authorizing such expansion and, in addition, making the 1962 covenant inapplicable with respect to bonds issued subsequent to the effective date of the new legislation.[29] For various reasons, however, this legislation was never implemented. Finally, in 1974, a new bi-state enactment was passed, after the OPEC oil embargo and the increased public awareness of the energy crisis confronting the nation. This legislation, which also authorized expansion of the PATH commuter railroad system, contained an outright repeal of the 1962 covenant, a repealer that purported to operate retroactively.[30] This law was the subject of the suit filed by the United States Trust Company of New York, as indenture trustee of all bondholders of the Port Authority. The company did not prevail in state court on its claims based on both the federal and New Jersey constitutions.[31] It then appealed its case to the United States Supreme Court.

B. The Decision of the Court

1. The Issue of an Impairment Vel Non

In deciding the constitutionality of the repealer legislation under the contract clause, the Court directed its analysis to two major questions: first, did the repeal of the 1962 covenant "impair" the obligation of the contract between the Port Authority and its bondholders[32] and second, if so, was this impairment proscribed by the contract clause?[33] This section will discuss the Court's analysis of the first of these two major issues.

As a preliminary matter, the Court had no difficulty concluding that the 1962 covenant constituted a contract between the holders of Port Authority's

Id. at 162-63, 338 A.2d at 855. The proposed expansion of the Port Authority Trans-Hudson Corporation (PATH) system would not satisfy either of the "permitted purposes" exceptions. Any extension clearly would not be self-supporting, and PATH operations were already producing such extensive deficits that the General Reserve Fund did not have any excess reserves.

28. 134 N.J. Super. at 165, 338 A.2d at 856.

29. 1972 N.J. Laws, ch. 208; 1973 N.Y. Laws, ch. 318.

30. 1974 N.J. Laws, ch. 25; 1974 N.Y. Laws, ch. 993.

31. United States Trust Co. v. State, 134 N.J. Super. 124, 197, 338 A.2d 833, 874 (1975), *aff'd per curiam*, 69 N.J. 253, 353 A.2d 514 (1976), *rev'd sub nom.* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977).

32. *See* 431 U.S. at 17-21.

33. *See id.* at 21-28.

consolidated bonds on the dates between the passage of the covenant in 1962 and its repeal in 1973.[34] Although the language of the contract clause itself is ambiguous, it was established at an early date in *Fletcher v. Peck*[35] that the clause was applicable not only to contracts between private parties, but also to those between the state and its citizens.[36] Since a legislature ordinarily does not bind future assemblies by its actions, however, it must be determined whether a given piece of legislation constitutes a "contract" so that it does have a prospectively binding effect.[37] As in the case of private contracts, the Court's primary inquiry is to determine whether the parties intended to enter into a legally binding contract.[38] Here, the Court had little difficulty in affirming the trial court's finding that the 1962 covenant was

34. The contract clause provides: "No State shall . . . pass any . . . law impairing the obligation of contracts . . . ." U.S. CONST. art. I, § 10. There is little authoritative history indicating precisely why the Framers included the contract clause in the Constitution. What authority does exist indicates that the Framers felt it necessary to protect the people from the whims and caprices of state legislatures which had often, for the sake of political expediency, altered the legal consequences of pre-existing contracts. *See* B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION (1938); Note, *Moratory Legislation*, 46 HARV. L. REV. 1061, 1068 (1933). As Chief Justice Marshall said:

> [T]he framers of the Constitution viewed with some apprehension, the violent acts which might grow out of the feelings of the moment; and that the people of the United States, in adopting that instrument, have manifested a determination to shield themselves and their property from the effects of those sudden and strong passions to which men are exposed.

Fletcher v. Peck, 10 U.S. (6 Cranch) 87, 137-38 (1810). And in the Federalist Papers, James Madison explained that the people "were weary of the fluctuating policy of state legislatures and wanted it made clear that under the new Government men could safely rely on States to keep faith with those who justifiably relied on their promises." THE FEDERALIST NO. 44, at 301 (J. Madison) (Cooke ed. 1961).

Although the ex post facto clause of article I, § 10 might at first appear to comprise an even more sweeping prohibition against retroactive legislation, the Supreme Court held at an early date that it applies only to criminal legislation or other legislation penal in nature. Cummings v. Missouri, 71 U.S. (4 Wall.) 277, 322-26 (1867); Calder v. Bull, 3 U.S. (3 Dall.) 386, 390-91 (1798). Similarly, the due process clause of the Fourteenth Amendment prohibits only that retrospective civil legislation which is unduly harsh and oppressive. Welch v. Henry, 305 U.S. 134, 147 (1938). *See* Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 14-20 (1976). As a result, the contract clause came to bear the major burden of protecting private parties against state legislation hostile to property rights; indeed, during the nineteenth century, the contract clause was probably one of the most litigated clauses of the Constitution. *See* Hale, *The Supreme Court and the Contract Clause*, 57 HARV. L. REV. 512, 513-14 (1944).

35. 10 U.S. (6 Cranch) 87 (1810).

36. *Id.* at 137-39. *Accord*, New Jersey v. Yard, 95 U.S. 104, 114 (1877). However, at least one scholar has concluded that there is no evidence that the Framers of the Constitution ever intended that the contract clause should be applicable to agreements to which the state is a party. B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION 15-16 (1938).

37. 10 U.S. (6 Cranch) at 135. *See generally* Kauper, *What is a "Contract" Under the Contracts Clause of the Federal Constitution?*, 31 MICH. L. REV. 187 (1932).

38. *See also* Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95, 104-05 (1938); Dodge v. Board of Educ., 302 U.S. 74, 78-79 (1937).

intended to constitute a contract between the two states and the holders of the consolidated bonds.[39]

At this juncture, however, the reasoning of the Court became more obscure. In virtually all previous cases on the subject, the Court had held that, even given the existence of a contract, not all legislation that repeals or modifies a portion of that contract constitutes an impairment. Rather, only legislation that materially or substantially alters the contract will so qualify.[40] Accordingly, a determination of the materiality of the impairment has, in the past, been a central feature of the Court's analysis in contract clause cases.[41] Indeed, this determination was one of the primary issues discussed by the trial court. That tribunal held that the repeal of the 1962 covenant did not materially undermine the contract so as to fall within the proscription of the contract clause.[42] The trial court found that the original purchasers of the bonds had relied, to some extent, on the existence of the covenant in purchasing the bonds and that the market price had fallen after the repealing legislation was passed.[43] However, it also observed both that the Port Authority bonds maintained "A" ratings from Moody's and Standard and Poor's, the two leading investment advisory services, after passage of the repealer and that the market price of the bonds had risen to a level comparable to that which had existed prior to the enactment of the 1974 legislation within a few months after the date of that enactment.[44] Thus, the ultimate conclusion of the trial court was that the plaintiff had not proven that the market price of the bonds was permanently and adversely affected by the repeal of the covenant and therefore there was no violation of the contract clause.[45] The Supreme Court, in a majority opinion written by Justice Blackmun,[46] did not dispute the trial court's basic findings of fact, but nevertheless refused to accept its ultimate conclusion that no material

39. The Court here examined both the language of the bonds themselves and the legislative history surrounding the passage of the covenant and concluded that both supported its conclusion that the legislature and the Port Authority intended the covenant to be a "contract" within the meaning of the contract clause. 431 U.S. at 17-18.

40. W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934); National Sur. Co. v. Architectural Decorating Co., 226 U.S. 276 (1912); Oshkosh Waterworks Co. v. City of Oshkosh, 187 U.S. 437 (1903); Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535 (1867); Planters' Bank v. Sharp, 47 U.S. (6 How.) 301 (1848).

41. *See* notes 55-60 and accompanying text *infra*.

42. 134 N.J. Super. at 196, 338 A.2d at 874.

43. *Id.* at 180-81, 338 A.2d at 864-65.

44. *Id.* at 179-82, 338 A.2d at 864-65.

45. *Id.* at 181-82, 338 A.2d at 866.

46. Justice Blackmun's opinion was joined by Chief Justice Burger and Justices Rehnquist and Stevens. 431 U.S. at 3. Justice Brennan wrote a dissenting opinion in which Justices White and Marshall joined. *Id.* at 33. Justices Powell and Stewart took no part in the decision of the case. *Id.* at 32.

impairment had resulted.[47] The Court justified its conclusion as follows. First, it said that the covenant was "not superfluous because it did limit the Port Authority's deficits and protected the General Reserve Fund from depletion.[48] Second, the covenant was not merely modified or replaced by a comparable provision but was totally repealed.[49] Finally, the legislature had not compensated the bondholders adversely affected by its repeal.[50]

This line of reasoning marks a significant departure from other recent contract clause cases and appears to mark a return to a rationale expressed by the Court early in the nineteenth century, when it at least nominally appeared to take an absolute view of the contract clause. For example, in *Green v. Biddle*,[51] the Court on rehearing held unconstitutional a series of Kentucky laws that impaired the rights of Virginia claimants to Kentucky lands. Justice Washington, in the majority opinion, presented what may be the most literal reading of the strictures of the contract clause ever given by the Court. He stated:

> The objection to a law, on the ground of its impairing the obligation of a contract, can never depend upon the extent of the change which the law effects in it. Any deviation from its terms, by postponing, or accelerating, the period of performance which it prescribes, imposing conditions not expressed in the contract, or dispensing with the performance of those which are, however, minute or apparently immaterial in their effect upon the contract of the parties, impairs its obligation.[52]

Two decades later, in *Planters' Bank v. Sharp*,[53] Justice Woodbury used equally strong language in finding that a state statute infringed the contract clause:

> One of the tests that a contract has been impaired is, that its value has by legislation been diminished. It is not, by the Constitution, to be impaired at all. This is not a question of degree or manner or cause, but of encroaching in any respect on its obligation, dispensing with any part of its force.[54]

Nevertheless, although language in some of its decisions supports an absolutist view of the contract clause, the Court has not always followed this interpretation. In *Von Hoffman v. City of Quincy*,[55] bonds were issued by a city pursuant to an Illinois law that authorized the levying of a special

47. *Id.* at 17-28.
48. *Id.* at 19.
49. *Id.*
50. *Id.*
51. 21 U.S. (8 Wheat.) 1 (1823).
52. *Id.* at 84.
53. 47 U.S. (6 How.) 301 (1848).
54. *Id.* at 327. *See also* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 256 (1827).
55. 71 U.S. 535 (1867).

property tax in an amount sufficient to pay interest on the bonds and placed the proceeds thus collected in a segregated fund for the sole benefit of bondholders. Subsequently, the legislature enacted a statute that limited the rate of the property tax that could be levied by municipalities and repealed the prior law allowing a special levy for the benefit of bondholders. The Court held this statute unconstitutional, but, in so doing, it did not employ the absolute language seen in prior opinions: "It is competent for the states to change the form of remedy, or to modify it otherwise as they may see fit, provided no substantial right secured by the contract is thereby impaired. . . . Every case must be determined upon its own circumstances."[56] Similarly, in his opinion for the majority in the original decision in *Green v. Biddle*,[57] Justice Story stated the governing test as follows: "If those acts so change the nature and extent of existing remedies, as materially to impair the rights and interests of the owner, they are just as much a violation of the compact, as if they directly overturned his rights and interests."[58]

In the most recent contract clause case involving municipal bonds, the Court also appeared to apply a less than absolute test. *W.B. Worthen Co. v. Kavanaugh*[59] involved a challenge by bondholders to an Arkansas statute that substantially modified the procedures available to them against a municipal improvement district that had defaulted on its bonds. The legislature had reduced the interest and penalties payable on default, increased the time in which the property was to be sold for nonpayment from sixty-five days to thirty-two months and permitted the property owner to remain in possession with a right of redemption for a further period of four years without having to account for rents received. The Court held that this legislation violated the contract clause, stating that "[w]ith studied indifference to the interests of the mortgagee or to his appropriate protection [the legislature has] taken from the mortgage the quality of an acceptable investment for a rational investor."[60] It then went on to state:

> Whether one or more of the changes effected by these statutes would be reasonable and valid if separated from the others, there is no occasion to consider. . . . The changes of remedy now challenged as invalid are to be viewed in combination, with the cumulative significance that each imparts to all. So viewed they are seen to be an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security.[61]

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56. *Id.* at 553-54. *See also* Edwards v. Kearzey, 96 U.S. 595, 601 (1878).

57. 21 U.S. (8 Wheat.) 1 (1823).

58. *Id.* at 17. A more absolute view of the contract clause was stated in the same case on rehearing in an opinion authored by Justice Johnson. *See* note 52 and accompanying text *supra*.

59. 295 U.S. 56 (1935).

60. *Id.* at 60.

61. *Id.* at 62.

For the past century the Court thus appears to have required some showing that the alleged impairment is not merely nominal, but "substantial" or "material" in nature. In *United States Trust*, however, the Court appears to be abandoning that test in favor of the absolutist interpretation espoused in *Green* and *Planters' Bank*. As noted earlier, the Court now seems to be saying that as long as the provision is "not superfluous," its repeal will be held to constitute an impairment unless it is replaced by an arguably comparable security provision or unless compensation is given to the bondholders to remunerate them for its value.[62]

The lack of a satisfactory explanation by Justice Blackmun in determining that an impairment existed is perhaps the weakest portion of his opinion. Nowhere does he attempt to explain his departure from the substantiality or materiality standards utilized in previous decisions; indeed, he does not even discuss cases such as *Von Hoffman* and *Worthen* in this portion of his opinion. Instead, he merely adopts a "not superfluous" criterion with little explanation.[63] Furthermore, the explanation given is unconvincing. First, the Court appears to deem it important that the provision in question was totally repealed and not merely modified or replaced by an "arguably comparable" security provision.[64] But, in so doing, the Court ignores other provisions of the bond indenture and of the enabling legislation that could make the total repeal of the covenant irrelevant. Most important, as the trial court recognized, the bondholders are still protected by the so-called "1.3 test," which prohibits the Port Authority from issuing new securities unless its net revenues available for debt service are estimated to be at least 1.3 times greater than the amount needed for all debt service on all outstanding and proposed bonds.[65] While the covenant that was repealed did provide even greater protection to the bondholders than the 1.3 test, under the materiality standard of *Von Hoffman* and *Worthen*, the Court should have

62. 431 U.S. at 19. The word "superfluous" is defined as "exceeding what is sufficient, necessary, normal or desirable." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 2294 (1961). This suggests that if a provision of the bond indenture has any possible utility to the bondholders, its repeal will violate the contract clause, at least if the legislature has made no effort to substitute another, comparable provision for it. Conceivably, then, a court could find a protective covenant not to be "material" when viewed in the context of the entire document, yet still find that it was "not superfluous" because it did provide some increment, however slight, of additional protection. *See* notes 69-72, 141-52 and accompanying text *infra*. By adopting the stricter "not superfluous" standard, the Court seems to imply that it is not prepared to apply the normal presumption of constitutionality to legislative intervention in or modification of municipal bond indentures. *See* notes 158-61 and accompanying text *infra*. For possible explanations of the Court's departure from the materiality standard, *see* notes 69-72, 141-52 and accompanying text *infra*.

63. *See* notes 47-50 and accompanying text *supra*.

64. 431 U.S. at 19.

65. *See* note 20 and accompanying text *supra*.

at least considered the other protections available to bondholders in deciding the threshold question of whether there was an impairment.[66]

Secondly, the Court's use of the argument that the state had deprived bondholders of property rights without just compensation in support of its position on the existence of an impairment *vel non* involves circular reasoning. It is true that the Court has held that the tests imposed under the just compensation clause of the Fifth Amendment and the contract clause are similar; thus, a contract right that is protected under the latter clause is a form of property for which just compensation must be given under the Fifth Amendment.[67] Notwithstanding this precedent, the Court's statement that the repeal of the covenant constituted an impairment because no compensation was paid to the bondholders is circular because, unless the repeal actually deprived the bondholders of some property right protected under the Fifth Amendment's just compensation clause, no compensation was due in any event.[68] Whether the case is analyzed under the just compensation clause or under the contract clause, *some* determination must be made of the extent of the substantive effect of the repeal on the bondholders' rights. Yet the Court simply fails to engage in such a determination.

However, it is notable that Justice Blackmun does not repudiate explicitly the concept of materiality in this portion of his opinion. Thus, it would seem presumptuous to conclude that the materiality standard of *Von Hoffman* and *Worthen* has been rejected, unless no alternative explanation can plausibly be advanced for the result reached by the Court in this portion of its opinion. Fortunately, there does appear to be an alternative explanation. After finding that the covenant was "not superfluous," the Court observes both that the legislature made no effort to compensate bondholders for its

66. The extent to which the covenant provided greater protection to bondholders than other available safeguards is not easy to determine. Curiously, there is no direct testimony on this point in the legislative history surrounding the adoption of the covenant. 134 N.J. Super. at 148-67, 338 A.2d at 949-55. The main difference would seem to be that the 1.3 test depends on the estimation of future net revenues of the Port Authority. The covenant, however, only allows acquisition of a passenger railroad by the Port Authority if (1) the Authority certifies that the railroad is "self-supporting" or (2) deficits generated will not exceed "permitted deficits" as defined in the covenant. *See* note 27 *supra*. Thus, it might be possible for the Port Authority to acquire legally a deficit-ridden commuter railroad which might, at the time of acquisition, satisfy the 1.3 test; yet, if the deficits exceeded expectations, as was the case with the Hudson & Manhattan, the Port Authority could find its credit rating impaired. On the other hand, acquisition of such a railroad under the covenant would be difficult, if not impossible. A railroad currently generating a deficit could hardly be certified as "self-supporting" under the first proviso. Furthermore, since the Hudson & Manhattan Railroad's losses were already consuming most of the available deficit under the "permitted deficits" proviso, this would not be available to authorize the acquisition.

67. Pennsylvania Hosp. v. City of Philadelphia, 245 U.S. 20 (1917). *See* City of El Paso v. Simmons, 379 U.S. 497, 553-54 (1965) (Black, J., dissenting).

68. East New York Sav. Bank v. Hahn, 326 U.S. 230 (1945); Veix v. Sixth Ward Bldg. &

repeal and that the covenant was not merely modified or replaced by an arguably comparable security provision.[69] In effect, then, Justice Blackmun is saying that since the legislature appeared to be totally unconcerned with the interests of the bondholders and apparently made no efforts to balance their interests against those of the state, he and his colleagues would not bother to engage in a detailed examination of the materiality of the impairment, but would instead *presume* that an impairment exists.

The language of the Court calls to mind that of *W.B. Worthen Co. v. Kavanaugh*.[70] There, in invalidating a state law limiting the remedies available to holders of certain municipal bonds, the Court stated that "[w]ith studied indifference to the interests of the mortgagee or to his appropriate protection [the state has] taken from the mortgage the quality of an acceptable investment for a rational investor."[71] Thus, what seemed to trouble the majority in *United States Trust*, as it did in *Worthen*, was that the legislature had acted with no apparent attempt to balance the interests of the creditors with those of the public at large. In such situations, the Court seems to be saying that it will not trouble itself with a detailed evaluation of the materiality or actual adverseness of an impairment when the legislature itself has made no such evaluation.[72]

Ironically, if the Court had found that the legislature had made such a determination, there would seem to be substantial grounds on which it could base a conclusion that the legislative judgment to repeal the covenant was justified. Even though the covenant was abrogated, the bondholders of the Port Authority were still protected by the safeguard of the 1.3 test[73] and that of the section 7 certification, both of which have been discussed earlier.[74] In the Court's view, it was the legislature's failure to engage in this balancing test or to consider other, less drastic alternatives than total repeal of the covenant that was fatal.[75]

2. *The Constitutionality of the Impairment*

Had *United States Trust* arisen a century ago, the Court's inquiry might well have stopped with the finding of an impairment. In early cases,

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Loan Ass'n., 310 U.S. 32 (1940); Honeyman v. Jacobs, 306 U.S. 539 (1939); Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937).

69. 431 U.S. at 19.

70. 295 U.S. 56 (1935).

71. *Id.* at 60.

72. In effect, the Court seems to be reversing the normal presumption of constitutionality which is ordinarily accorded to acts of Congress. *See* notes 158-61 and accompanying text *infra*.

73. *See* note 20 and accompanying text *supra*.

74. *See* note 21 and accompanying text *supra*.

75. Before concluding this section, it should be pointed out that the Court also refused to

the Court seemed to indicate that once an impairment was found, then it automatically followed that there was a violation of the contract clause.[76] Over the years, however, the Court came to recognize that in certain circumstances, the policies that the contract clause was designed to protect might conflict with what is loosely termed the "police power" of the state.[77] Thus, a mere finding that certain legislation constitutes an impairment does not always lead to the conclusion that it also violates the contract clause. Before that determination is made, the courts must balance the interests protected by that clause against the interests furthered by the police power reserved to the states by the Tenth Amendment; if the latter are found to outweigh the former, then no violation of the contract clause will be found.

Home Building & Loan Association v. Blaisdell[78] is a seminal case in

base its decision on the right-remedy distinction which had been a popular method of analysis in older contract clause decisions. This method of analysis distinguished between legislation that altered a substantive right under the contract, which was forbidden by the contract clause, and legislation that merely affected the *remedy*, which was permitted. The distinction was first clearly articulated by Justice Trimble in Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827). The Court has used this distinction to uphold, *inter alia*, laws abolishing imprisonment for debt, Maison v. Haile, 25 U.S. (12 Wheat.) 370 (1827), and laws restricting the right of a mortgagee to a deficiency judgment, Gelfert v. National City Bank, 313 U.S. 221 (1941); Honeyman v. Jacobs, 306 U.S. 539 (1939); Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937). *But see* Bronson v. Kinzie, 42 U.S. (1 How.) 311 (1843).

For several reasons, however, the Court has come to discard the right-remedy distinction in recent years. First, it is apparent that, in the words of Judge Learned Hand, "a right without a remedy is a meaningless scholasticism . . . ." Wood & Selick v. Compagnie Générale Transatlantique, 43 F.2d 941, 943 (2d Cir. 1930). Thus, a severe impairment of the remedy can render the substantive rights which exist of theoretical value only, since there is no meaningful way to enforce them. Second, the term "remedy" came to be applied by the Court not merely to procedural changes but also to certain substantive changes in the promisor's rights as well, thus blurring the original distinction. *See, e.g.*, W.B. Worthen Co. v. Thomas, 292 U.S. 426 (1934) (law exempting proceeds of insurance policies from attachment for payment of debts of insured held unconstitutional); Von Hoffman v. Quincy, 71 U.S. (4 Wall.) 535 (1867) (statute limiting amount of tax which could be assessed to pay off previously issued bonds held unconstitutional); Bronson v. Kinzie, 42 U.S. (1 How.) 311 (1843) (law restricting price at foreclosure sale to at least two-thirds of appraised value held unconstitutional). The Court discussed these cases in terms of the right-remedy distinction even though the statute did not involve a remedy in the procedural sense at all. Third, the Court has come to recognize that, whether or not the impairment is one of a remedy or a right is irrelevant in terms of the policies underlying the contract clause; rather, the materiality of the impairment is the significant factor in deciding whether the contract clause has been violated. The explicit rejection of the right-remedy distinction in the Court's two most recent contract clause decisions indicates that the Court has administered the coup de grace to it. United States Trust Co. v. New Jersey, 431 U.S. 1, 19-21 n.17 (1977); City of El Paso v. Simmons, 379 U.S. 497, 506 (1965).

76. *See, e.g.*, Planters' Bank v. Sharp, 47 U.S. (6 How.) 301 (1848); Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827); Green v. Biddle, 21 U.S. (8 Wheat.) 1 (1823); Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810).

77. *See, e.g.*, City of El Paso v. Simmons, 379 U.S. 497 (1965); East New York Sav. Bank v. Hahn, 326 U.S. 230 (1945); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934).

78. 290 U.S. 398 (1934).

the modern era of contract clause interpretation, in which the Court explicitly recognized that the protection afforded by that clause was not absolute, but must be reconciled with other, potentially conflicting provisions of the Constitution. The case involved a challenge to the Minnesota Mortgage Moratorium Law, enacted in 1933 in the severest part of the Depression to provide relief to mortgagors who would otherwise have lost their property. The Act authorized, *inter alia*, the postponement of foreclosure sales and the extension of redemption periods at the discretion of the state courts; by its terms, it was to remain in effect only during the continuance of the emergency and, in no event, beyond May 1, 1935. It also required the mortgagor in default who remained in possesion to pay to the mortgagee the reasonable rental value of the property, as fixed by a court.[79] In a five to four decision, the Supreme Court upheld the constitutionality of this legislation. Chief Justice Hughes, in the course of his majority opinion, made statements that have been quoted on several occasions by the Court in subsequent contract clause cases. He noted that "while emergency does not create power, emergency may furnish the occasion for the exercise of power."[80] Next, he observed that "the prohibition [of the contract clause] is not an absolute one and is not to be read with literal exactness like a mathematical formula."[81] Third, Chief Justice Hughes stated that "[n]ot only is the Constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.' "[82] Applying these principles, the Court proceeded to sustain the Minnesota mortgage moratoria legislation after finding that: (1) an emergency existed; (2) the legislation was addressed to a legitimate end; (3) the conditions of the legislation were not unreasonable because the chief concern of the mortgagees, protection of their investment security, was not substantially impaired; and (4) the legislation was temporary, continuing only for the duration of the emergency.[83]

The significance of the *Blaisdell* case in the modern era of contract clause litigation cannot be overemphasized. It marked a fundamental change in the Court's attitude towards the nature and degree of protection provided by that clause. Prior to *Blaisdell*, the Court seemed to regard the protec-

79. 1933 Minn. Laws, ch. 339.
80. 290 U.S. at 426.
81. *Id.* at 428.
82. *Id.* at 434-35.
83. *Id.* at 444-47.

tion of the contract clause as an absolute one, although application of the threshold requirement of materiality admittedly did afford the Court more flexibility than it was willing to acknowledge explicitly. The *Blaisdell* case marked perhaps the most explicit recognition by the Court that this protection must be read in the context of the entire constitutional scheme and that other constitutional safeguards could come into play that would prevent a rigid application of the contract clause.[84] In particular, the opinion recognized that policy considerations may modify the guarantee of that clause. Thus, for the first time, the Court expressly adopted a balancing test to determine whether the contract clause prohibited the legislation being challenged. This balancing test has been followed by the Court in virtually all contract clause cases succeeding *Blaisdell*, until *United States Trust*.[85] This interpretation of the contract clause had probably been encouraged by the tendency of the Court to apply a balancing test to most of the constitutional protections afforded by the First, Fifth and Fourteenth Amendments.[86] As a result, many had come to believe that the protection afforded by the contract clause was similar to that afforded by the due process clause of the Fifth Amendment.[87]

The Court in *United States Trust* justifies its departure from the *Blaisdell* rationale on several grounds. First, it painstakingly points out that when the state impairs the obligation of a contract to which it is a party, it is necessary to determine whether that contract was of a type wherein it is proper for a state to bind itself in the future. On this issue, the Court had little difficulty finding that substantial precedent exists for the state to be

84. The Great Depression of the 1930's and ensuing collapse of real estate prices led to many attempts by state legislatures to pass legislation to protect the mortgagee from foreclosure, as was the case with the legislation in *Blaisdell*. These acts met with varying degrees of success in surviving constitutional challenges under the contract clause. *See generally* Bunn, *The Impairment of Contracts: Mortgage and Insurance Moratoria*, 1 U. CHI. L. REV. 249, 249-65 (1933); Skilton, *Mortgage Moratoria Since 1933*, 92 U. PA. L. REV. 53 (1943).

85. Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940); Honeyman v. Jacobs, 306 U.S. 539 (1939); Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937); W.B. Worthen Co. v. Thomas, 292 U.S. 426 (1934).

86. *See, e.g.*, Konigsberg v. State Bar, 399 U.S. 36 (1961); Williamson v. Lee Optical Co., 348 U.S. 483 (1955); Day-Brite Lighting, Inc. v. Missouri, 342 U.S. 421 (1952); United States v. Carolene Prods. Co., 304 U.S. 144 (1938); Nebbia v. New York, 291 U.S. 502 (1934); Schenck v. United States, 249 U.S. 47 (1919).

87. 431 U.S. at 60-61 (Brennan, J., dissenting). However, any analogy which might be drawn between the due process clauses of the Fifth and Fourteenth Amendments on the one hand, and the contract clause on the other would appear to be of dubious validity. The very language "due process of law" would seem to compel a balancing of interests on a case-by-case basis in order to determine what process is "due" under the circumstances. The contract clause in contrast, is phrased in rather absolute terms. Its language indicates that the Framers placed a high value on upholding the integrity of individual decisions made in the free market and

able to bind itself in the future with respect to matters involving the taxing and spending powers.[88] The Court then pointed out that the security provision impaired by the 1974 repealer was "purely financial" and thus did not involve a situation in which the state had surrendered an essential attribute of its sovereignty.[89] In so characterizing it, the Court managed to distinguish this case from those such as *Stone v. Mississippi*,[90] in which a state constitutional provision abolishing lotteries was held not to violate the contract clause merely because the legislature had previously granted a charter to a private company to operate a lottery. In cases such as *Stone*, it was impossible for the state to exercise its police power to eliminate the supposed evil of gambling without impairing the previous contract.[91] In *United States Trust*, however, the Court seems to say that the interests served by the contract clause should be paramount because, while the Port Authority's lucrative revenue-generating operation of tunnels and bridges was a desirable source of revenue to finance mass transit, it was not the *only* source. Thus, there were alternative methods of furthering the police power interests of New York and New Jersey without impairing the obligations of existing contracts.

This conclusion does not solve the Court's doctrinal problem, however, since the mere existence of alternative methods of dealing with the problems of mass transportation, energy conservation and environmental protection does not mean that the legislature *must* choose the least restrictive of them. In a series of cases, the Court has established that actions by a legislature that involve economic regulation are entitled to a strong pre-

distrusted subsequent legislative attempts to tamper with such bargains. Thus, applying a balancing test to the contract clause, particularly if the acts of the legislature were accorded the normal strong presumption of constitutionality, would render nugatory the protection which the Framers intended the contract clause to provide. *See* note 34 *supra*.

88. *Id.* at 23-24. Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810), established early in the history of the contract clause that the legislature has the power to bind future legislatures if it intends to do so, at least with respect to certain subjects.

89. 431 U.S. at 24. The Court here cited New Jersey v. Wilson, 11 U.S. (7 Cranch) 164 (1812), which held that the state could properly grant a permanent tax exemption and that the contract clause prohibited subsequent legislation impairing that agreement. However, as authority for the proposition that a legislature does have the power to enter into contracts which are binding under the contract clause with respect to financial matters, this case is weak authority. While never expressly overruled, *Wilson* has been severely limited in subsequent cases. *See, e.g.*, New York *ex rel.* Clyde v. Gilchrist, 262 U.S. 94 (1923); Seton Hall College v. South Orange, 242 U.S. 100 (1916); Rochester Ry. v. Rochester, 205 U.S. 236 (1907); Wisconsin & Michigan Ry. Co. v. Powers, 191 U.S. 379 (1903); Morgan v. Louisiana, 93 U.S. 217 (1876).

90. 101 U.S. 814 (1880).

91. There are several other cases besides *Stone* in which the Court has invoked the police power to support impairment of a prior legislative act which might be characterized as contractual. However, in these cases, unlike the present case, impairment of the contract was essential

sumption of constitutionality.[92] As a corollary, the Court has often held that it is not its responsibility to second guess the legislature concerning the desirability of various alternative means of solving a problem.[93] Thus, based on precedent, it would not have been surprising for the Court to have held the repealer valid on the theory that it could not substitute its judgment for that of the duly-elected legislatures of New York and New Jersey. Notwithstanding such precedent, Justice Blackmun indicated that "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self interest is at stake."[94] In effect, then, the Court held that the normal presumption of constitutionality is either weakened or abolished entirely when the alleged impairment involves a contract to which the state is a party.

The Court's new principle seems to be supported by common sense. After all, there is a stronger reason to presume that the legislature is acting in an impartial manner when it is considering a proposed law that may impair a contract between two private parties, rather than one in which the state itself has a direct pecuniary interest.[95] In the former case, it is reasonable to assume that the legislature is in as good or perhaps an even better position than a court to balance the private interests protected by the contract clause against the public interest embodied in the police power. In the latter case, however, the political reluctance of a legislature to raise taxes makes it all too likely that it will turn to the most ready source of funds available, even if this choice interferes with a preexisting contractual obligation. Thus, presumably in a case such as *Blaisdell*, the legislature had no particular reason to favor the interests of the mortgagor over the mortgagee.[96] In *United*

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if the police power interest was to be accomplished. *See, e.g.*, Atlantic Coast Line R.R. v. Goldsboro, 232 U.S. 548 (1914) (city ordinances severely limiting railroad's right to operate within city limits held constitutional despite prior state charter and contract giving railroad right to operate within city); Fertilizing Co. v. Hyde Park, 97 U.S. 659 (1878) (where the Court found adoption of city ordinance prohibiting operation of fertilizing company within city limits constitutional, notwithstanding prior legislative grant of corporate charter to operate fertilizer company within city limits). In contrast, in *United States Trust*, the police power interest which the legislature intended to further did not directly involve the bondholder's rights to adequate security; other means of furthering the states' interests would have been available which would not have impaired the bondholders' rights. 431 U.S. at 29-30.

92. *See, e.g.*, Goldblatt v. Hempstead, 369 U.S. 590 (1962).

93. City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974); City of El Paso v. Simmons, 379 U.S. 497 (1965).

94. 431 U.S. at 26.

95. One problem with the Court's analysis is that, if the principle laid down is to apply to all legislation in which the state has a direct pecuniary interest, it will apply to virtually all cases involving the taxing and spending powers. Yet in other cases the Court has tended to give the legislature wider discretion in exercising these powers rather than narrowing the scope of this power. *See* note 88 and accompanying text *supra*.

96. Since the legislation challenged in *Blaisdell* involved private mortgage contracts, theoretically the legislature could exercise its impartial judgment. As a practical matter, how-

States Trust, on the other hand, the legislature had a substantial financial self-interest in the enactment in question. The Port Authority had long been regarded enviously by proponents of mass transportation as one of the few state agencies with surplus funds.[97] Consequently, that surplus was an obvious source of money for the purchase of mass transit systems, particularly when the only feasible alternative would have been to raise taxes in an area that already has one of the highest tax rates in the nation.

On the other hand, the Court's conclusion in this respect is also subject to attack. Where the interest of the state itself is at stake, arguably the action of the legislature in impairing a contract is entitled to at least as great a presumption of constitutionality as in other cases, since that action will affect a public contract, a matter about which the state necessarily has a high degree of concern. Indeed, in *Chicago, Burlington & Quincy Railroad v. Nebraska ex rel. Omaha*,[98] the Court said:

> Usually, where a contract, not contrary to public policy, has been entered into between parties competent to contract, it is not within the power of either party to withdraw from its terms, without the consent of the other; and the obligation of such a contract is constitutionally protected from hostile legislation. Where, however, the respective parties . . . are persons or corporations whose rights and powers were created for public purposes, by legislative acts and where the subject-matter of the contract is one which affects the safety and welfare of the public, other principles apply. . . . The presumption is that, when such contracts are entered into, it is with the knowledge that parties cannot, by making agreements on subjects involving the rights of the public, withdraw such subjects from the police power of the legislature.[99]

Furthermore, it can be argued that in many cases not involving the state's pecuniary interest, political forces may exist that encourage the legislature to impair a contractual obligation that are even stronger than those present when exercise of the taxing or spending powers is involved.[100] Thus, the Court's conclusion can hardly be called self-evident and merits much more discussion than it received.

II. The Consistency of *United States Trust* with Prior Decisions

The most intriguing question to be answered in connection with the

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ever, in times of general financial difficulty, political pressures tend to favor debtors more strongly than creditors. Thus, it could be argued that in all cases involving legislation granting relief to, or otherwise favoring, debtors at the expense of creditors, close judicial scrutiny is proper.

97. *See* 134 N.J. Super. at 141, 338 A.2d at 842.

98. 170 U.S. 57 (1898).

99. *Id.* at 72.

100. The great number of mortgage moratoria acts passed during the Great Depression of the 1930's can be used as an example.

United States Trust decision is whether it signals the advent of a new era in contract clause interpretation, as Justice Brennan's dissent suggests,[101] or whether it is logically reconcilable with other recent decisions construing that clause. Stated another way, does *United States Trust* signal a return to a pre-*Blaisdell* attitude toward the contract clause or, alternatively, is it consistent with the *Blaisdell* line of analysis? It has been suggested in the previous section that the instant ruling is sufficiently different on its facts from *Blaisdell* that no definite conclusions can be drawn based on that latter case.[102] But what about subsequent decisions?

Perhaps the two most difficult post-*Blaisdell* opinions are those of *Faitoute Iron & Steel Co. v. City of Asbury Park*[103] and *City of El Paso v. Simmons*.[104] *Faitoute* involved a challenge by a group of bondholders of the City of Asbury Park, New Jersey, to the constitutionality of legislation passed by that state's legislature to deal with the growing problem of municipal insolvencies caused by the Depression. That legislation provided for a type of municipal receivership plan that authorized the state supreme court, upon the application of creditors, to place an insolvent city under control of a Municipal Finance Commission.[105]A supplementary act provided that a plan of adjustment or composition of the claims of creditors could be submitted on their behalf to the state court.[106] If the plan was approved by the city, the state Commission and the holders of a least eighty-five percent of the municipality's outstanding bonds, the court was authorized to accept the plan, which would then become binding on all creditors, whether they had voted for it or not. The City of Asbury Park was placed under the control of the Municipal Finance Commission in 1935. Subsequently, a plan for the refunding of its bonded debt was submitted to the state supreme court. The plan, in essence, provided for the exchange of existing bonds for new securities with a maturity date thirty years longer and with a lower interest rate than the present bonds. After the plan had been approved by over eighty-five percent of the city's creditors, the nonconsenting minority bondholders sued, claiming that the legislation under which the refunding was made violated the contract clause. The constitutionality of this legislation was eventually sustained by the Supreme Court, for reasons discussed below.

The *Faitoute* case is the only one in the twentieth century in which the Court has sustained legislation modifying the rights of preexisting bond-

101. 431 U.S. at 33-62 (Brennan, J., dissenting).
102. *See* notes 88-92 and accompanying text *supra*.
103. 316 U.S. 502 (1942).
104. 379 U.S. 497 (1965).
105. N.J. STAT. ANN. 52:27-34 to -39. 5 (West 1955).
106. *Id.* at -34 to -36.

holders against a challenge based on the contract clause.[107] This is especially significant since the case also involved more drastic impairments of the contractual obligation than existed in *United States Trust* or some of the other cases in which the Court has deemed a given impairment unconstitutional. In *United States Trust*, the states had eliminated a security provision restricting the ability of the Port Authority to engage in the passenger railroad business in certain circumstances; at the time this legislation was passed, the credit rating of the Port Authority was impeccable and there was no likelihood of its default in the foreseeable future upon any of its debt obligations.[108] In contrast, in *Faitoute*, two very fundamental provisions of the old municipal bonds were modified. The maturity span of the new bonds issued was thirty years longer than that of the old ones, and the new bonds carried a lower rate of interest than their predecessors. Only the amount of principal remained unchanged. Thus, the modification in *Faitoute* involved not merely a security provision, but the basic financial obligation of the city.

In view of this, it might be argued that the decision in *United States Trust* marks a new era in the evolution of the contract clause. Upon closer examination, however, this conclusion is not inevitable. First of all, in *Faitoute*, the Court based its decision on the fact that the bondholders' legal right to sue the city on the basis of the shorter maturity date for payments of principal and interest then due was, as a practical matter, an "empty right" which could not be exercised meaningfully.[109] The Court pointed out that the city's taxing power was not unlimited; no court would allow creditors to interfere with that power and divert revenues needed for the preservation of essential services to retire outstanding bonds. It then stated that the right to pursue a "sterile litigation" is not a right protected by the contract clause. Phrased differently, the Court in *Faitoute* seemed to be saying that there had been no substantial impairment of the obligation involved therein because the right to sue the city to collect the stated principal and interest did not for all practical purposes exist.

The application of this same line of reasoning in *United States Trust*, however, would not lead to a similar conclusion. The right of the Port Authority bondholders not to have the debtor involved in the operation of deficit-ridden railroads seems to be a very real and substantial right; indeed, its very purpose is to prevent the bondholders from being stranded in the

107. The Court has, admittedly, decided only a handful of contract clause cases involving municipal bonds. *See* W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935), discussed in notes 59-61 and accompanying text *supra*; Louisiana v. Pilsbury, 105 U.S. 278 (1882); Murray v. Charleston, 96 U.S. 432 (1878); Trustees of the Wabash of Erie Canal Co. v. Beers, 67 U.S. (2 Black) 448 (1862).

108. 134 N.J. Super. at 179, 338 A.2d at 864.

109. 316 U.S. at 510.

position of the hapless plaintiffs in *Faitoute* who had no real choice but to accept whatever the city chose to give them.[110]

Secondly, the Court in *Faitoute* seemed to place emphasis on both the good faith of the city and the unforeseen financial hardships that had contributed to its problems. The Court seemed impressed by the fact that the city was making a good faith effort to honor its commitments to its bondholders to the greatest extent possible consistent with its need to maintain its essential operations. Furthermore, the advent of the Great Depression was a factor not within the city's control and one which was definitely unforeseen at the time the bonds in question were issued. Thus, the Court concluded that "[t]he necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation for the very reason that thereby the obligation is discharged, not impaired."[111]

One might argue that the Court might have invoked the "implied condition" argument in *United States Trust* as well, and the fact that it did not do so evinces a significant change in the Court's attitude toward the contract clause. The circumstances surrounding the passage of the legislation repealing the covenant in *United States Trust*, however, were significantly different from those existing in *Faitoute*. In the former case, the repealing legislation was clearly of no benefit to the bondholders and was designed solely to aid the states of New York and New Jersey. Furthermore, there was no unforeseen change in conditions in this case that would lend an aura of good faith to the legislature's actions, similar to that which existed in *Faitoute*. Indeed, the fear of potential purchasers of Port Authority bonds that it would become embroiled in the losing proposition of mass transit

110. Generally, experience seems to support the conclusion of the Court in *Faitoute* that the bondholder's right to litigate against the state or municipality is useless as a practical matter. The history of the 1930's is replete with instances of municipal officers evading service of process by bondholders and even going to jail rather than ordering payment of the bondholder's claims, despite a court decree to do so. In addition, courts generally would refuse to issue mandamus orders requiring payment to bondholders in the face of other pressing needs of the city. *See generally* Dession, *Municipal Debt Adjustment and the Supreme Court*, 46 YALE L.J. 199 (1936) [hereinafter cited as Dession]; Fordham, *Methods of Enforcing Satisfaction of Obligations of Public Corporations*, 33 COLUM. L. REV. 28 (1933); Shanks, *The Extent of Municipal Defaults*, 24 NAT'L MUNICIPAL REV. 32 (1935). There are, however, a few states which afford a creditor of a municipality the right to obtain execution against private property of the residents of the debtor taxing district to satisfy a judgment against it. ME. REV. STAT. tit. 30, ch. 241, § 5053 (1965); N.H. REV. STAT. ANN. ch. 530, § 8 (1974); VT. STAT. ANN. tit. 12, § 2743 (1973). Had the Court in *Faitoute* been dealing with an example of such legislation, it may well have reached a different result.

111. 316 U.S. at 511. As the Court has properly recognized, the public interest and the values underlying the contract clause would not be served by so rigid an interpretation of the clause as to destroy the financial capabilities of local governments altogether. While the contract clause indicates that the Framers placed great value on the need to preserve the

financing was precisely the reason why the 1962 covenant was inserted in the bonds.[112] At the time of the issuance of those securities, the bondholders foresaw that there would be increasing political pressures on the Port Authority to involve itself in mass transit and demanded some assurance that the security underlying their investment would not be substantially damaged by such an involvement. To allow repeal of the covenant precisely because the fears of the bondholders had been realized would seem to constitute a breach of good faith on the part of the legislature and a clear violation of the legitimate expectations of the bondholders.[113] Thus, invoking the implied condition rationale of *Faitoute* would appear to be contrary to the intent of the parties.

Third, in upholding the refunding in *Faitoute*, the Court emphasized the practicalities of the situation; the scheme adopted was the only way to assure payment of municipal debt obligations while at the same time maintaining viable city governments. The Commission, in adopting the refunding plan, had acted with an intent to benefit the bondholders as well as the city and, in fact, over eighty-five percent of the bondholders had approved the proposal. Furthermore, there was some objective evidence that the plan actually did benefit the bondholders since the market price of the old defaulted bonds had risen substantially since its adoption.[114]

The situation in *United States Trust* was far different from that in *Faitoute*. There could be no good faith claim that the 1974 repealer benefited the bondholders' specific interests. In fact, it eliminated a security provision and gave them nothing of benefit in return. Indeed, the states admitted as much, since under the terms of the 1962 legislation they could have repealed the covenant with the approval of sixty percent of the bondholders; yet they had not even tried to do this, presumably because they realized that the repeal would be unacceptable to those creditors.[115] Thus, on its facts, *United States Trust* is much closer to the situation presented in *W.B. Worthen Co. v. Kavanaugh*,[116] where the legislature was found by the Court to have acted with studied indifference to the interests of the creditor. In short, then, while one may question whether the Court dealt fairly with the facts in *Faitoute*, one must conclude that on the basis of legal

integrity of market transactions, the very existence of a free market presupposes the existence of stable governmental entities. Thus, the Court in *Faitoute* was, in effect, recognizing that the contract clause does not prevent the legislature from taking reasonable action necessary to preserve the kind of general economic stability necessary for the free market to function.

112. 134 N.J. Super. at 156, 338 A.2d at 851.

113. *See* notes 147-52 and accompanying text *infra*.

114. 316 U.S. at 513.

115. 431 U.S. at 28.

116. 295 U.S. 56 (1935).

doctrine, there is nothing in the latter opinion that is inconsistent with the Court's pronouncements in *United States Trust*.[117]

More difficult to reconcile with the decision in *United States Trust* is *City of El Paso v. Simmons*.[118] That case involved a challenge to legislation modifying an 1897 Texas statute.[119] The original statute provided for the sale of state public lands, with the proceeds to be allocated to the Texas school fund. The terms of sale were extremely liberal, providing for a down payment of one-fortieth of the principal and annual payment thereafter of principal and interest over an extended period of time. In the event of a default by the purchaser on an annual payment of interest, the statute authorized termination of the sale contract and forfeiture of the property in question to the state. Most significantly, the original statute authorized the vendee of land that had been so forfeited to reinstate his claim to that property at any date in the future, merely by paying into the state treasury all accrued, unpaid interest from the date of default to the date of reinstatement, provided that the rights of third persons had not intervened during the interim.

The apparent purposes of the statute were to encourage the homesteading of virgin Texas lands and to raise money for the state's school fund. After its passage, however, valuable oil and gas deposits were discovered in Texas, and the provisions in question came to have substantial and largely unintended benefit for speculators, who would buy up large tracts of land to establish a right of reinstatement at a later date if valuable minerals were subsequently discovered on those properties. As a result of this speculation and a concomitantly large number of title disputes, the redemption provision in question was amended in 1941, limiting the right to redeem to a time period within five years from the date of forfeiture.[120] *Simmons* involved a challenge to the 1941 amendment by the subsequent vendee of a purchaser of a tract of state land who had originally acquired title to the property prior to the passage of the amendment. When the plaintiff attempted to exercise his right of redemption slightly more than five years after default, the state refused to reconvey the land to him and subsequently sold it to the city of El

117. One may question the Court's assertion that the defendant's motive in providing for the refunding of its debt obligations was really to benefit the bondholders. At best, there is scant evidence given by the Court to support its conclusion. And even assuming, arguendo, the correctness of this assertion, the Court's decision would still seem to deprive the bondholders of the opportunity of taking no immediate action and awaiting the return of more normal economic times when the bonds could be paid in full with accrued interest from the date of default. *See* Dession, *supra* note 110, at 202-03.

118. 379 U.S. 497 (1965).

119. 1895 Tex. Gen. Laws, ch. 47, *as amended by* 1897 Tex. Gen. Laws, ch. 129, art. 4218f.

120. TEX. REV. CIV. STAT. ANN. art. 5326 (Vernon 1962) (repealed 1977).

Paso. A suit to quiet title followed, in which the plaintiff argued that the 1941 law, as applied retrospectively, violated the contract clause.

The Court rejected this argument. In so doing, it appeared to apply a balancing test in weighing the state's police power interests against the interests of private parties protected by the contract clause. The Court found that the state had substantial interests in preventing speculators from reaping windfall profits as an unintended benefit of the original legislation and in eliminating the resultant confusion over title to land, which had caused excessive litigation. On the other side, the Court felt that the perpetual option feature was of relatively minor importance to the original purchasers of the land. It concluded, applying the presumption of constitutionality to the legislation, that the state's interests should prevail.[121]

Although not a municipal bond case, *Simmons* is closely analogous to *United States Trust*, since both involve situations in which the challenged legislation conferred a direct, pecuniary benefit upon the state while at the same time infringed the contractual rights of private parties. *Simmons* is perhaps even more difficult than *Faitoute* to reconcile with *United States Trust*; but since the majority in the latter case did not overrule *Simmons*, it seems safe to assume that the prior ruling is still good law. How, then, can the latter case be distinguished from *United States Trust*? There are several distinctions that suggest themselves.

First, the circumstances that led to the problems that the Texas legislation was designed to remedy were totally unforeseen at the time the original statute was passed in 1910. At that juncture, it was assumed that the land would be utilized for homesteading or for agricultural purposes and no one suspected that it might be found to contain valuable minerals. The perpetual redemption feature was designed to enable homesteaders or farmers who had defaulted on a land contract to redeem it when a good year came along. The discovery of oil and gas in Texas in the 1920's, however, led to the use of the perpetual redemption clause by speculators as a form of option contract, something never envisaged by the legislature. In turn, this led to great speculation in the school lands, which inflated their market values to the detriment of small farmers. In addition, it led to much litigation over land titles among successive purchasers of the same parcel of land, all of whom attempted to exercise rights of redemption whenever valuable minerals were discovered in nearby parcels.[122]

121. 379 U.S. at 515-16.

122. The majority opinion in *Simmons* may be based either primarily on (1) the desire to prevent speculators from reaping unintended windfall profits or (2) the need to clear up uncertainties regarding the status of land titles and to prevent excessive litigation over them. If the former is the main basis for the Court's sustaining the legislation, then it is arguable that *Simmons* was incorrectly decided, since the state's financial self-interest in undoing the effects of what turned out to be a bad bargain is not strong enough to justify overriding the contract clause. Indeed, it is precisely this type of situation which the contract clause was designed to

In contrast, the situation that led to passage of the repealer in *United States Trust* was not only reasonably foreseeable at the time the legislation was passed but, in fact, was the very reason why the covenant itself was inserted in that legislation. The legislative history, as described in detail in the trial court's opinion, indicated that many financial experts believed that involvement of the Port Authority in mass transit would seriously impair its credit standing and ability to sell bonds unless some limit on the extent of that involvement was included in the enabling statutes.[123] Thus, it would have been a much more drastic step for the Court to have allowed in *United States Trust* modification of the deficit-limiting covenant than it would have been for the Court to have allowed the remedial legislation in *Simmons*, because in the former case the very fears that had led to the insertion of the covenant in the first place became a reality, whereas in the latter case the discovery of oil and gas deposits was not anticipated at the time the statute was passed.

An analogy can be drawn in this respect to the use of the foreseeability test by courts in determining whether the doctrine of impossibility of performance should excuse the promisor from performing a contractual obligation. In many cases involving the defense of impossibility of performance at common law or under section 2-615 of the Uniform Commercial Code, the courts have refused to excuse the promisor if the contingency causing the impossibility was reasonably foreseeable at the time the contract was entered into.[124] The rationale underlying this line of analysis is that a party should be presumed to have intended to assume the risk of the occurrence of such a contingency if he saw or should have foreseen it at the time the contract was made, but took no steps to guard against it.[125] Similarly, in the case of legislation that is challenged under the contract clause, it can be argued that if a problem was foreseeable by the legislature at the time a law was enacted affecting the rights of another, that body should not be allowed to alter its previous position on which third parties have relied, absent some drastic change of circumstances that was unforeseen at the time of the original enactment.[126]

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guard against. On the other hand, if the need to eliminate clouds on titles was the predominant reason for the decision, then it rests on a more substantial basis. In this case, the legislature was acting as an impartial social arbiter attempting to preserve economic order, not as a financially interested party seeking retroactively to modify a bad bargain.

123. 134 N.J. Super. at 156, 338 A.2d at 851.

124. Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966); Maple Farms, Inc. v. City School Dist., 76 Misc. 2d 1080, 352 N.Y.S. 2d 784 (Sup. Ct. 1974); U.C.C. § 2-615, Comment 1. *See generally* Hurst, *Freedom of Contract in an Unstable Economy*, 54 N.C.L. REV. 545 (1976).

125. Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966).

126. Obviously, there must be limits to the application of this foreseeability criterion, lest it

In *United States Trust*, it can be argued that the passage of the Clean Air Act[127] and the energy crisis, coupled with the Arab oil embargo, did amount to such drastically changed circumstances as to justify the invocation of the police power by the state in order to modify the Port Authority's contracts.[128] But, although different in degree, this was precisely the type of event that led potential buyers of Port Authority bonds to demand the inclusion of the 1962 covenant in the first place.[129] Certainly, New York City's traffic congestion and air pollution are not new phenomena.

The second distinguishing feature of *Simmons* concerns the importance to the plaintiff of the provision that was impaired. In that case, the Court indicated that the primary motivation of the original purchasers of Texas school lands was to obtain immediate possession and use of those properties.[130] The liberal redemption provision was merely a "sweetener" designed to induce the purchaser to enter into the contract. However, since the purchaser's right of redemption could be cut off if the land was sold to a subsequent vendee after the original purchaser had defaulted, the length of time during which this option would last was entirely fortuitous; it could

unduly limit the ability of the legislature to pass laws in furtherance of the police power. Thus, merely because subsequent events are generally conceivable at the time a contract is entered into should not be sufficient to invoke the bar of the contract clause. On the other hand, where a specific provision of the contract is drafted to provide protection from some specific event, and the subsequent occurrence of that event is a primary cause of the passage of consequent legislation impairing that contract, invocation of the contract clause seems generally desirable to protect the legitimate expectations and reliance of the contracting party. *See* notes 147-52 and accompanying text *infra*.

127. Although the Clean Air Act, 42 U.S.C. §§ 1857 to 1857*l* (1970 & Supp. V 1975) (current version at 42 U.S.C.A. §§ 7401-7642 (West Pamph. 1977) (amended 1977)), was initially adopted in 1955, prior to the passage of the covenant challenged in *United States Trust*, it was the 1970 amendments to the Act which greatly tightened permissible air quality standards and gave greater impetus to the movement for increased mass transit in the New York area. *See* 42 U.S.C. §§ 1857c-1 to 1857c-6f (1970).

128. Although the 1973 oil embargo instituted by the Organization of Petroleum Exporting Countries (OPEC) was itself only a temporary phenomenon, it did focus the attention of the country on developing shortages of fossil fuels and the consequent need for energy conservation. This in turn led to passage of the Regional Rail Reorganization Act of 1973, which contained specific findings that "[r]ail service and rail transportation offer economic and environmental advantages with respect to . . . energy efficiency and conservation . . . to such extent that the preservation and maintenance of adequate and efficient rail service is in the national interest." 45 U.S.C. § 701(a)(5) (Supp. V 1975). Also, in 1974, the New Jersey Legislature passed the Emergency Energy Fair Practices Act. 1974 N.J. Laws, chs. 2, 6. Based on these developments, it could be argued that the air pollution and energy situation had deteriorated to a point far worse than which could have been envisioned in 1962, when the covenant was passed, and that therefore legislative modification was permissible under the contract clause. While this seems to be Justice Brennan's position in his dissent, 431 U.S. at 32-37, 44-61 (Brennan, J., dissenting), it would seem that his argument that these events were unforeseeable in 1962 is supported by slim evidence at best.

129. *See* note 27 *supra*.

130. 379 U.S. at 514-15.

extend indefinitely if the land was not resold by the state, or it could be cut off immediately if the land was promptly resold. In fact, the Court pointed out, most of the land was promptly resold. For these reasons, the majority believed that the redemption provision was not a primary consideration motivating potential buyers to purchase such properties. However, this state of affairs changed drastically following the discovery of oil and gas, since the redemption feature made it possible for speculators to obtain what amounted to an option on land by buying it, immediately defaulting, and waiting to redeem until oil and gas were discovered nearby.

In *United States Trust*, in contrast, it is clear that the existence of the covenant limiting Port Authority participation in mass transportation was an important factor in inducing potential purchasers to invest in the Authority's bonds. One may dispute whether, in fact, the covenant did provide substantial protection to buyers in view of the existence of the 1.3 test and other limitations on the Authority's borrowing powers. Nonetheless, it seems clear that a reasonable and prudent potential buyer of the bonds could deem the covenant crucial to his decision to invest. Thus, at least if one accepts the majority's interpretation of the facts in *Simmons*, there is a substantial difference in the importance attached to the contractual provisions that were subsequently repealed between that case and *United States Trust*.[131]

Third, in *Simmons*, the only effective means of correcting the problems created by changed circumstances was by modifying the perpetual redemption provision. To clear up the uncertainty over land titles and to prevent speculative inflation of land values that had been caused by the original perpetual redemption provision, the only feasible remedy was to alter the provision. Thus, the situation in *Simmons* was similar to that presented in *Stone v. Mississippi*[132] and other police power cases in which the exercise of that power necessarily involved an impairment of the contract.

In *United States Trust*, however, alternative means of dealing with the problems that led to passage of the repealer did exist. In the first place, the Port Authority was not the only governmental agency that could possibly

131. For a contrasting view, see Justice Black's spirited dissent in *Simmons* in which he stated that:

> To my way of thinking it demonstrates a striking lack of knowledge of credit buying and selling even to imply that these express contractual provisions safeguarding credit purchasers against forfeitures were not one of the greatest, if not the greatest, selling arguments Texas had to promote purchase of its great surfeit of lands.

379 U.S. at 530 (Black, J., dissenting). If the majority had accepted this contention, that the perpetual redemption feature was of major importance, it would be exceedingly difficult to reconcile the holding in *Simmons* with that in *United States Trust*.

132. 101 U.S. 814 (1879). *See* cases cited note 91 *supra*.

deal with the problem of mass transit. While it was relied on by the legislature because of its relative financial well-being, another bi-state agency could theoretically have been created and funded with general state and federal revenues in order to deal with mass transit.[133] Secondly, even assuming that Port Authority involvement was the only way in which mass transit subsidization was practically possible, given the fiscal position of both states, it is feasible that less drastic modifications of the covenant could have been made that would not have impaired so significantly the security of existing bondholders. For example, it would have been possible to amend the covenant to exclude revenues derived from new bridge, tunnel and toll road projects undertaken by the Authority, or to exclude the incremental revenues derived from raising tolls on existing facilities. Alternatively, the amount of the permitted deficits under the covenant could have been increased without totally abandoning all spending limitations. In short, the distinguishing factor in *United States Trust* is that alternative means of dealing with the problem existed and, even if these alternatives were not practically feasible, the legislature totally repealed the existing legislation, without attempting to enact a compromise modification.[134] Fourth, the challenged legislation in *Simmons* did not completely eliminate the purchaser's right of redemption, but merely limited it to five years.[135] In *United States Trust*, on the other hand, the legislature totally eliminated the covenant in question, without apparent consideration of the interests of the bondholders. In short, the balancing of interests evidenced by the legislature

133. Concededly, there are many practical difficulties which would make the formation of another bi-state agency a difficult and time-consuming task. First, the legislatures of New Jersey and New York must agree on and pass similar legislation creating such an agency, a task not easy to accomplish, as was demonstrated by the difficulty in agreeing on the 1962 covenant and its subsequent repeal. *See* 134 N.J. Super. at 159, 169-71, 338 A.2d 853, 859-60. Secondly, as an agreement between two states, the bi-state compact must be ratified by Congress. U.S. CONST. art. I, § 10, cl. 3.

134. The trial court's opinion indicates that several alternatives to repealing the covenant were considered and rejected. In 1971, legislation was introduced in the New Jersey legislature to extend the scope of PATH to include rail lines to Newark International Airport and Kennedy International Airport, which the sponsors contended would be part of each "air terminal" rather than a "passenger railroad" subject to the covenant. However, a negative opinion from counsel foreclosed adoption of this scheme. Subsequently, a consulting firm was retained by the Commissioner of the New Jersey Department of Transportation in 1971 to report on the Port Authority's ability to finance an extension of PATH. The consultant concluded that the only way this could be done would be to remove PATH from the Port Authority's control so that the covenant would no longer apply. Third, in 1972 the New York Legislature passed a bill repealing the covenant with respect to bonds issued after its effective date, but retaining the covenant for bonds issued between 1962 and 1972. 1972 N.Y. Laws, ch. 1003. This bill, however, was unacceptable to the legislature of New Jersey. 134 N.J. Super. at 170-71, 338 A.2d at 859-60.

135. TEX. REV. CIV. STAT. ANN. art. 5326 (Vernon 1962) (repealed 1977). *See* text accompanying note 120 *supra*.

in *Simmons* was not self-evident in *United States Trust*.[136]

One factor that does seem irreconcilable is the Court's attitude towards the presumption of constitutionality. The Court in *Simmons* stated that it "must respect the 'wide discretion on the part of the legislature in determining what is and what is not necessary.' "[137] In contrast, the Court in *United States Trust* indicated that where the financial interests of the state are involved the normal deference that the Court grants to the presumption of validity of legislation does not apply.[138] To the extent that the concerns motivating the legislation in question in *Simmons* consisted of a desire to prevent excessive litigation and speculation, it is possible to argue that that case is not one involving the pecuniary interests of the state and that this fact explains the difference in treatment evinced in *United States Trust*. However, the legislation in *Simmons* does confer financial benefits on the state since the state, rather than the private individual, will reap the speculative profits on the land, unless it is repurchased within five years. Thus, *Simmons* does involve, to some extent, the financial interests of the state, although perhaps not to the same degree as in *United States Trust*.

Conclusion

Historically, judicial construction of the contract clause has not been one of the stronger areas of the United States Supreme Court's jurisprudence.[139] Litigation involving that clause has tended to produce opinions that are nebulous and which often ignore prior cases that are directly relevant.[140] Furthermore, they tend to badly divide the Court, thus producing a multiplicity of opinions in the same case.

Those contract clause cases dealing with the impairment of municipal bond covenants are no exception to this general characterization. Indeed, *United States Trust* was decided by a four-to-three margin, with two justices abstaining. Thus, its precedential value is somewhat dubious, since Justice Blackmun's opinion did not muster an absolute majority of the Court. Nevertheless, some tentative conclusions and predictions may be ventured as to the probable course of future contract clause litigation involving municipal bonds.

The first major conclusion to be drawn from the opinion in *United States Trust* is that the Court will give great weight to the importance which

136. *See* notes 158-61 and accompanying text *infra*.

137. 379 U.S. at 508-09.

138. *See* notes 92-100 and accompanying text *supra*.

139. *See generally* B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION (1938); Hale, *The Supreme Court and the Contract Clause*, 57 HARV. L. REV. 512 (1944).

140. *E.g.*, El Paso v. Simmons, 379 U.S. 497 (1965); Home Bldg. & Loan Ass'n v.

the individual contracting parties attached to the covenant at the time the contract was made. It has been observed earlier that the Court in *United States Trust* has abandoned the materiality or substantiality standard that prior contract clause opinions indicated must be met in order to determine whether the legislation being challenged constitutes an impairment within the meaning of that clause.[141] In its place, the Court now has indicated that it is more in keeping with the policies underlying the formulation of the contract clause to defer to the intent of the contracting parties, as long as a covenant is not superfluous.

This hypothesis would seem to explain why Justice Blackmun's opinion regarded as irrelevant the lengthy inquiries made by the trial court concerning the effect of the repealing legislation on the market price of the bonds, and the existence of other protective covenants in the enabling legislation.[142] Instead, he focused on the legislative history, which indicated that both Port Authority officers and prospective underwriters believed that the bonds would be unmarketable without the protective covenant. Thus, when he stated that the importance of the covenant to the bondholders is irrelevant, he was saying that the Court should ordinarily honor the parties' determination of the materiality of a given contractual convenant rather than substitute its judgment on this point. Although never explicitly stated, this tendency to focus on the parties' own determination of materiality can be found in other recent contract clause cases as well. In *Simmons*, for example, one of the reasons why the Court was willing to allow the shortening of the perpetual redemption to five years was that it found that this right was of little or no importance to the original purchasers of the land.[143] Similarly, in *Faitoute*, the Court emphasized that the purchasers of the bonds must have anticipated some modifications of the stated terms of repayment would be necessary in the event of serious economic problems.[144] Thus, it would seem prudent for prospective purchasers or underwriters of municipal bonds to build a clear legislative history indicating the importance that they attach to the terms and conditions stated in a municipal bond indenture. The more evidence there is to indicate that a given provision is important to the purchasers, the more difficult it will be for the Court to sustain legislation impairing such provisions.

While the Court's shift to a standard of subjective materiality is significant, one must be careful not to overemphasize its practical importance for

Blaisdell, 290 U.S. 398 (1934); Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827); Green v. Biddle, 21 U.S. (8 Wheat.) 1 (1823).

141. *See* notes 63-68 and accompanying text *supra*.

142. *See* notes 69-74 and accompanying text *supra*.

143. 379 U.S. at 514. *But see* 379 U.S. at 530 (Black, J., dissenting).

144. 316 U.S. at 511.

two reasons. First, it seems doubtful that the Court will carry this subjective standard to extremes and hold that a truly inconsequential provision of a bond indenture is immune from impairment under all circumstances, even if the evidence is clear that the purchasers specifically desired it. In other words, there are probably some limits of reasonableness to this subjective standard. Perhaps the limits are found in Justice Blackmun's statement that here the covenant was "not superfluous."[145] Second, in most cases, the true intentions of the purchasers will not be as clear as they were in *United States Trust*. The vast majority of municipal bonds are issued at a time when the credit rating of the issuer, and therefore the marketability of the bonds, is unquestioned. Thus, the terms of the bond indenture will be determined unilaterally by the issuer and there will be no indications of the purchaser's expectations and desires at the time of purchase. *United States Trust* was unique with respect to the amount of legislative history generated in connection with the issuance of the bonds. This was largely due to the widespread realization of the effect that Port Authority involvement in mass transit operations could have on its credit standing.[146] However, in most cases the Court will only be able to guess as to the expectations of the bondholders; thus, in the vast majority of cases the difference between an objective standard and a subjective one will be academic.

The second conclusion that might be drawn from *United States Trust* relates to the significance of the foreseeability factor in contract clause litigation. The Court's opinion seems to indicate that if the conditions that led to the passage of legislation impairing a prior contract were foreseeable and were contemplated by the parties at the time of their original agreement, the Court will be reluctant to sustain the impairing legislation.[147] This would be particularly true where the repealing legislation affected particular portions of the contract which were specifically bargained for with a view to those foreseeable conditions later realized. Specifically, in *United States Trust*, underwriters and potential purchasers of the bonds correctly foresaw in 1962 that conditions in the New York metropolitan area were such that the need for public financial support for commuter railroad facilities would intensify in the coming years, and that political pressures for Port Authority involvement in mass transit would also increase in intensity.[148] It was for this reason that the original covenant limiting Port Authority involvement was included in the enabling legislation and in the bond indenture. Thus, it would seem inequitable and unjust to allow subsequent repeal of the covenant on which purchasers of the bonds relied merely because those

145. 431 U.S. at 19.
146. *See* notes 24-30 and accompanying text *supra*.
147. *See* 431 U.S. at 31-32; *see* notes 121-29 and accompanying text *supra*.
148. 134 N.J. Super. at 153-54, 338 A.2d at 849.

conditions that were foreseen came to pass. Conversely, in *Simmons*, the discovery of oil and gas that gave the right of perpetual redemption a great speculative value was not a development which was predictable at the time the legislation authorizing the sale of public lands was enacted.[149] Therefore, the Court said that it was not inequitable to modify retroactively this redemption feature in light of unforeseen subsequent developments.

Thus, the fact that a given covenant has been inserted into a bond indenture to protect against specific developments that are foreseen as threatening the bondholders' future security is a powerful factor militating against the constitutionality of subsequent legislation repealing that covenant. This is not to say, however, that foreseeability per se will automatically immunize a municipal bond covenant against subsequent legislative modification or repeal. As the dissent in *United States Trust* correctly indicated, foreseeability, in itself, has never been a fundamental criterion in contract clause litigation.[150] In a broad sense, everything is foreseeable, so that sweeping applicability of that criterion would immunize virtually any contract against subsequent legislative modification or repeal.[151] Thus, application of the foreseeability doctrine must be limited to those situations in which (1) a specific event is predictable and (2) specific provisions are inserted in the contract to protect the bondholders against the occurrence of that event. These limitations explain why the legislation in *Faitoute* was upheld, although it involved a more drastic modification of the rights of the bondholders than did that in *United States Trust*. While the possibility of national economic catastrophe is always theoretically possible and, therefore, foreseeable, it is an occurrence of a generalized nature, and one which would affect a great number of contracts made at a given time. Furthermore, no specific limitations were inserted in the indenture agreement in *Faitoute* designed to deal specifically with this type of occurrence. Thus, the subsequent modification of the terms of repayment of the bondholders in that case does not shock the conscience in the same manner as does the repeal of the covenant in *United States Trust*.[152]

The third major conclusion to be drawn from *United States Trust* is that the nature of the contingency that has led to the legislation allegedly impairing the contract is of great significance. If the circumstances leading

149. 379 U.S. at 511.

150. 431 U.S. at 59-60 (Brennan, J., dissenting).

151. *See* notes 121-29 and accompanying text *supra*.

152. In one sense, the legislation in *Faitoute* was a far more severe impairment of contract rights than was that in *United States Trust*. *Faitoute* involved a primary impairment of the bondholders' right to timely payment of principal and interest, while *United States Trust* involved a secondary impairment of a covenant providing additional security for payment. It is on a subjective level that the impairment in *United States Trust* is more severe, since it involved

to legislative action have resulted from the conduct or the failure to act by the issuing governmental agency, the Court will be much less sympathetic to the legislation than if the emergency is the result of external forces beyond the control of the legislature. *United States Trust* is an excellent example of this phenomenon. Here, the problem with the deficit-ridden mass transit systems of the New York metropolitan area had existed for virtually the entire post-war era, yet the legislature had been unable to come up with a satisfactory solution.[153] Finally, in 1962, the situation had deteriorated to the point where requiring the Port Authority to take on commuter railroad systems that would almost certainly generate large deficits would have raised serious doubts as to the Authority's credit standing, so that the only way in which it was financially feasible for it to acquire the deficit-ridden Hudson & Manhattan line was to insert the covenant at issue in order to placate prospective investors. Merely because the state legislatures allowed the situation to deteriorate further, so that in 1974 they were compelled to repeal that covenant, is not a satisfactory reason for taking that drastic step.

This factor is even more apparent in the case of *Flushing National Bank v. Municipal Assistance Corp.*,[154] in which the Court of Appeals of New York held that the moratorium on New York City notes violated the state's constitution. While external circumstances had undoubtedly contributed to New York City's financial woes, the Court of Appeals felt that this was no excuse for successive city administrations to conceal the true extent of the problem through budget manipulations and misleading balance sheets, which if made in connection with the issuance of securities in a private corporation would almost certainly have subjected the individuals involved to civil and criminal liability under the federal securities laws.

In contrast, those cases in which the Court has upheld legislation impairing a contract have usually involved relief from circumstances beyond the control of the issuer. In *Faitoute*, for example, the source of the problem was the Great Depression of the 1930's, the causes of which clearly were not within the control of the Asbury Park City Council.[155] And in *Simmons*, the source of the problem was the discovery of valuable oil and gas following passage of the legislation authorizing the sale of school lands; again, this was a factor that was not only unforeseen but also beyond the control of the legislature.[156] It follows, then, that the Court is likely to be

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the repeal of a covenant that was specifically bargained for by the bondholders and the abrogation of which was being sought precisely because those circumstances which the bondholders had foreseen when they bargained for the covenant had come to pass.

153. 134 N.J. Super. at 148-74, 338 A.2d at 846-61.

154. 40 N.Y.2d 731, 358 N.E.2d 848, 390 N.Y.S.2d 22 (1976).

155. *See* notes 103-05 and accompanying text *supra*.

156. *See* notes 118-20 and accompanying text *supra*.

more sympathetic to legislation impairing municipal bond covenants in situations where the difficulties involved arise from such factors as a generalized downturn in the economy, and less sympathetic in situations where the difficulties of a municipality are a result of inept handling of its own finances.[157]

Fourth, and perhaps most significant of all, it would appear that in the case of legislation impairing municipal bonds, the Court will no longer apply the presumption of constitutionality that it ordinarily gives to economic regulations enacted by a legislature. As a practical matter, this means that any impairing legislation that, in the Court's judgment, goes beyond the minimum necessary to grant the required relief will be suspect and will have difficulty in passing constitutional muster.[158] Thus, the legislature must balance the interests of the bondholder and the issuer in determining whether the impairment is permissible. If it appears that the legislature did not even consider the interests of the bondholder, as in *United States Trust*, the legislation will be presumed to be unconstitutional.[159]

The importance of this shift in the presumption of constitutionality cannot be overstated. Many contract clause cases, whether involving impairment of municipal bonds or other matters, involve an exceedingly difficult balancing of interests easily affected by any alteration of evidentiary burdens. A shift of the burden of proof to the state has thus far been invoked by the Court only in a few select areas, such as legislation involving racial[160] and national origin[161] classifications that are challenged under the Fifth or Fourteenth Amendments. If the Court in *United States Trust* is saying that legislation furthering a state's financial self-interest is to be treated similarly to laws involving other "suspect classifications" previously mentioned, one must wonder whether this position will be able to muster the support of a fifth justice and thus become the position of a majority of the Court. Until the Court again considers the question, it seems only prudent to assume that the contract clause must be considered as a significant limitation on legislation modifying the rights of municipal bondholders.

157. Although the case was decided under the New York Constitution and thus did not involve the contract clause of the United States Constitution, Justice Breitel's opinion in *Flsuhing National Bank* reflects this philosophy even more explicitly than does *United States Trust*. *See* 40 N.Y.2d at 735-37, 358 N.E.2d at 851-52, 390 N.Y.S.2d at 26.

158. *See* notes 97-99 and accompanying text *supra*.

159. *See* notes 69-75 and accompanying text *supra*.

160. Brown v. Board of Educ., 347 U.S. 483 (1954); Korematsu v. United States, 323 U.S. 214 (1944).

161. Hernandez v. Texas, 347 U.S. 475 (1954).