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CASE COMMENTS

CONSTITUTIONAL LAW: CONTRACT CLAUSE PROTECTION OF MUNICIPAL BOND OBLIGATIONS

United States Trust Co. v. New Jersey, 97 S. Ct. 1505 (1977)

In an action to protect its bond holdings, the United States Trust Company of New York brought suit for declaratory relief to stop the repeal of a New Jersey statute that established the conditions of the bonds.¹ The plaintiff urged the court to uphold the 1962 statutory covenant² between the states of New York and New Jersey and the bondholders.³ This statute limited the extent to which revenues and reserves securing the bonds issued by the Port Authority⁴

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1. The bonds were issued between 1962 and 1973 by the Port Authority of New York and New Jersey, see note 5 *infra*, to finance bistate mass transit operations. The bonds were protected by a 1962 statutory covenant that restricted the use of revenues and reserves securing the bonds. See notes 2-4 *infra*. In 1974 the New York and New Jersey legislatures retroactively repealed the 1962 covenant. In an effort to protect its holdings, United States Trust Company challenged the repeal, suing on its own behalf and on behalf of all bondholders as holder of some \$72 million in affected bonds. By concurrent legislation, the two states had in 1973 prospectively repealed the 1962 covenant, and their power to do so has not been challenged. Bonds issued after the 1973 repeal were not at issue in the instant case.

2. N.J. STAT. ANN. §32:1-35.55 (West 1963); N.Y. UNCONSOL. LAWS §6606 (McKinney Supp. 1971).

3. The concurrent statutory covenant read in part: "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 as provided in their contract with the port authority, . . . (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." N.J. STAT. ANN. §32:1-35.55 (West 1963); N.Y. UNCONSOL. LAWS §6606 (McKinney Supp. 1971). Part (a) of §32:1-35.55, which promises that the state will not impair the Port Authority's control over its fees and services, has not been repealed and was not in issue in the present case.

4. The trial court described the financial structure of the Port Authority and explained the need for protection of the bondholders' interest by covenant: "From its inception, with the exception of monies advanced as loans by the states, the Authority was required to finance its facilities solely with money borrowed from the public and to be repaid out of the revenues derived from its operations. By reason of these financial limitations two concepts initially emerged which have played an important role in the realization of the purposes for which the Authority was created: first, the specific projects undertaken by the Authority should be self-supporting . . .; and second, since the Authority is a public agency over which its creditors have no direct control, the bondholders should be protected by covenants with the Authority and with the states which have ultimate control over its operations." *United States Trust Co. v. New Jersey*, 134 N.J. Super. 124, 139-40, 338 A.2d 833, 841 (1975).

could be used to subsidize future urban mass transit operations.⁵ In 1974, in response to the developing national energy crisis,⁶ the New Jersey and New York legislatures retroactively repealed the 1962 covenant to free additional funds for expansion of mass transit facilities.⁷ The trust company argued that the 1974 New Jersey statute was an illegal impairment of the state's contractual obligation with the bondholders⁸ in violation of the contract clause of the United States Constitution.⁹ The New Jersey trial court upheld the legislation, finding that the statutory repeal was a reasonable exercise of the state's police power.¹⁰ The New Jersey supreme court affirmed.¹¹ On appeal, the Supreme Court of the United States reversed and HELD, the retroactive repeal of the 1962 covenant was an unnecessary and unreasonable impairment of the state's contractual obligation, offensive to the contract clause of the United States Constitution.¹²

In the wake of the American Revolution, extensive state interference with private and public contracts threatened the substantial destruction of commercial credit relations.¹³ The contract clause¹⁴ was adopted to reestablish

5. The Port Authority at its inception in 1921 was concerned almost exclusively with carrier freight transportation and not with commuter transit. It was not until the 1950's that the two states expressed interest in mass transit operations. 97 S. Ct. 1505, 1508-10 (1977). In 1960 New York and New Jersey proposed the takeover of the privately owned, deficit-ridden Hudson and Manhattan Railroad. It was feared that the deficits created by Port Authority involvement in passenger railway operations would deplete the reserves securing the bonds in question. This has proved to be a very real concern in light of the current operation of the four existing New York City transit systems at annual deficits of \$60 million, \$10 million, \$15 million, and \$20 million. The 1962 statutory covenant was the response to this concern. Appellant's Jurisdictional Statement at 13.

6. On November 27, 1973, Congress enacted the Emergency Petroleum Allocation Act of 1973, 15 U.S.C.A. §§751-760 (West 1976). In that Act, Congress observed that the hardships resulting from the oil shortage "jeopardize the normal flow of commerce and constitute a national energy crisis which is a threat to the public health, safety and welfare." 15 U.S.C.A. §751(a)(3) (West 1976).

7. 1974 N.J. Laws, ch. 25; 1974 N.Y. Laws, ch. 993, §1.

8. A similar suit challenging the parallel New York statute has been pending since 1974. *United States Trust Co. v. New York*, No. 09128/74 (N.Y. County S. Ct. 1974).

9. "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . ." U.S. CONST., art. I, §10, cl. 1.

10. *United States Trust Co. v. New Jersey*, 134 N.J. Super. 124, 197, 338 A.2d 833, 874 (1975): "It is the judgment of this court that the repeal litigation was a reasonable and hence valid exercise of the states' police power which is not prohibited by the Contract Clause of either the Federal or the State Constitution."

11. *United States Trust Co. v. New Jersey*, 69 N.J. 253, 353 A.2d 514 (1976). The supreme court affirmed "substantially for the reasons" set forth in the opinion of the trial court. *Id.* at 256, 353 A.2d at 515.

12. 97 S. Ct. 1505 (1977) (Blackmun, J.) (Berger, C.J., concurring; Brennan, White, Marshall, JJ., dissenting; Stewart, Powell, JJ., taking no part in the decision).

13. Chief Justice Marshall recognized the gravity of the situation in *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827). "The mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith." *Id.* at 354-55.

14. U.S. CONST., art. I, §10, cl. 1. Because the contract clause has largely been replaced by fifth and fourteenth amendment guarantees against unlawful taking of property without due process of law, it has attracted little attention from legal commentators in recent years. For

economic stability and order.¹⁵ In *Fletcher v. Peck*,¹⁶ the leading early decision, the Supreme Court established that the terms of the contract clause, read literally, condemned not only state impairment of purely private agreements but also legislative modification of state contractual obligations.¹⁷

The early cases became less significant, however, following Supreme Court limitations on the scope of contract clause protections.¹⁸ This transition was signaled by increasing judicial deference to legislative discretion. Even as early as *Ogden v. Saunders*,¹⁹ in which the Court upheld the authority of the legislature to impair contractual relationships prospectively,²⁰ the Supreme Court justified its holding in part by deferring to the wisdom of the legislature.²¹

This deference was consistent with notions of expanding state dominion under the guise of the police power that were prevalent at that time. The state's inherent power to legislate to protect the public health, morals, and welfare was declared by the Court to exceed any constitutional right concerning private contracts.²² Furthermore, because the police power was inalien-

the most comprehensive treatment, see generally WRIGHT, *THE CONTRACT CLAUSE OF THE CONSTITUTION* (1938); Hale, *The Supreme Court and the Contract Clause* (pts. 1-3), 57 HARV. L. REV. 512, 621, 852 (1944).

15. The restriction has been interpreted as only limiting state action and has no application to congressional acts or federal administrative agency actions. See, e.g., *Continental Ill. Nat'l Bank v. Chicago R.I. & P. Ry.*, 294 U.S. 648 (1935).

16. 10 U.S. (6 Cranch) 87 (1810) (deeming a public land grant a contract and holding the repeal of this grant an unconstitutional impairment of a contractual obligation).

17. This doctrine was unexpectedly advanced in *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819), in which the Supreme Court ruled that a corporate charter granted by the state was a contract, and that legislation materially altering the charter was an impairment of the obligation of contracts. *Id.* at 652.

18. In response to the literal interpretation of the contract clause in *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810) and *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819), the Supreme Court soon searched for means to circumvent the absolute prohibitions mandated by the contract clause. One method of accomplishing this result was to create a distinction between contractual remedy and obligation. If modification of the remedy did not impair the underlying obligation, the contract clause was not offended. See, e.g., *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819).

In the instant case, the Supreme Court analyzed the distinction in terms of the subjective expectations of the parties, particularly the legitimate expectations of the contracting parties. "[A] reasonable modification of statutes governing contract remedies is much less likely to upset expectations than a law adjusting the express terms of an agreement." 97 S. Ct. at 1516 n.17. See generally Hale, *supra* note 14, at 533-57.

19. 25 U.S. (12 Wheat.) 213 (1819) (upholding a state insolvency law that discharged both the debtor and his future acquisitions of property from all liability on proof of certain facts).

20. *Id.* at 270. A necessary corollary to and implication of this holding was that a party could not negate the state's legislative power by contracting around it. Any contract entered into after enactment of a law by the state impliedly incorporated and operated subject to that law; for that reason the contract could not be impaired by the law. See *Hudson County Water Co. v. McCarter*, 209 U.S. 349, 357 (1908).

21. *Ogden v. Saunders*, 25 U.S. (12 Wheat.) at 270.

22. See, e.g., *West River Bridge v. Dix*, 47 U.S. (6 How.) 507, 532 (1817). According to one commentator, the reason for this deference was the desire of the courts to protect legislation guarding vital public interests. Existing private contracts, they felt, should not subvert the more significant interests and needs of the public at large. Note, *The Continuing Vitality of the Contract Clause of the Federal Constitution*, 40 S. CAL. L. REV. 576, 587 (1967).

able,²³ any attempt by a legislature to contract away the state's reserved power was held void *ab initio*.²⁴

State exercise of the police power triumphed over explicit constitutional prohibitions against the impairment of contracts in *Home Building & Loan Association v. Blaisdell*.²⁵ In this leading contract clause case, the Court considered legislative impairment of certain private contracts in the form of real property mortgages. The impairment resulted from passage of the Minnesota Mortgage Moratorium Act,²⁶ the state legislature's response to the economic emergency occasioned by the Depression. The Act temporarily extended the period for redemption of existing mortgages, thereby forbidding foreclosures. The *Blaisdell* Court eschewed the opportunity to hold the mortgage moratorium merely an alteration of remedies, as had been conveniently done in similar prior litigation to reach the desired result.²⁷ It preferred to view the law as a valid exercise of the state's police power designed to protect vital public interests in property.²⁸ While not the type of interest to which legislatures had customarily addressed their police power in the past,²⁹ the state's desire to safeguard the mortgagee-purchaser relationship during a period of economic emergency impressed the Court.³⁰

The existence of the emergency was crucial to the Court's decision to uphold the moratorium.³¹ The emergency afforded a legitimate reason for the enactment,³² and the Court concluded that the legislation was a reasonable response³³ appropriately limited in duration.³⁴ Furthermore, the Court's de-

23. *Stone v. Mississippi*, 101 U.S. 814 (1879). "[T]he legislature cannot bargain away the police power of a State." *Id.* at 817.

24. *Butcher's Union Co. v. Crescent City Co.*, 111 U.S. 746 (1884) (upholding an 1881 grant of privileges to operate a slaughterhouse in New Orleans despite an exclusive grant of the privileges to another slaughterhouse in 1879); *Stone v. Mississippi*, 101 U.S. 814 (1879) (upholding an 1868 act of the Mississippi legislature prohibiting lotteries that had been permitted by an 1867 grant of a 25-year lottery charter); *Newton v. Commissioners*, 100 U.S. 548, 562 (1879) (upholding the power of the state to modify legislation that "permanently established" a county seat in one city by designating a new location).

25. 290 U.S. 398 (1934). The *Blaisdell* decision was noted in 47 HARV. L. REV. 660 (1934) and 18 MINN. L. REV. 319 (1934).

26. MINN. STAT. §339.514 (1933).

27. See note 18 *supra*. The Court found the distinction between remedy and obligation inappropriate and instead used the police power rationale. Since the Court directly held that a state could impair contracts in certain prescribed situations, it did not need to discuss the distinction between remedy and obligation. 290 U.S. at 434-35.

28. *Id.* at 434, 437. The Court relied on the earlier case of *Manigault v. Springs*, 199 U.S. 473, 480 (1905), for its definition of the police power.

29. See Note, *supra* note 22, at 588.

30. 290 U.S. at 444-45. See also Note, *supra* note 22, at 588: "If the moratorium law had been held unconstitutional, many property owners would have lost their land in foreclosure proceedings, and the prospect of widespread foreclosure would have further depressed real estate values, bringing financial ruin to many persons."

31. "While emergency does not create power, emergency may furnish the occasion for the exercise of power." 290 U.S. at 426.

32. *Id.* at 445.

33. *Id.* at 438.

34. "The Act is to remain in effect 'only during the continuance of the emergency and in no event beyond May 1, 1935.'" *Id.* at 416.

cision contained the seed that would allow the future expansion of state assertion of its police power. The Court recognized "a growing appreciation of public needs" and the necessity of courts' "finding ground for a rational compromise between individual rights and public welfare."³⁵ The Court thereby intimated that future legislation might be upheld under less drastic circumstances.³⁶

Subsequent decisions did in fact bear out this prognosis. In *Veix v. Sixth Ward Building & Loan Association*,³⁷ the Court held that in order to safeguard the solvency of building and loan associations a state legislature may, consistent with the contract clause, restrict existing rights of certificate holders to withdraw the amount of their certificates.³⁸ In so doing, the Court discarded the requirements that the legislation be in response to a continuing emergency and that the relief measure be temporary.³⁹ The Court in *East New York Savings Bank v. Hahn*,⁴⁰ in sustaining the tenth extension of a New York mortgage moratorium, was similarly unconcerned with the absence of an emergency.⁴¹ Rather, the Court emphasized the necessity of judicial respect for the "wide discretion on the part of the legislature in determining what is and what is not necessary."⁴²

In the continuing trend, the Court recognized the need for judicial deference to legislative purpose in *City of El Paso v. Simmons*,⁴³ the most recent contract clause case. Texas law had provided an interest-defaulting purchaser of public land the right to reinstate his interest in the property upon any later payment of delinquent interest. A later amendment limited the reinstatement period to five years from the forfeiture date. Furthermore, the property would revert to the state following the five-year period. The petitioner in *El Paso* challenged this amendment as a violation of the contract clause,⁴⁴ but the Supreme Court upheld the constitutionality of the statute.⁴⁵ Despite the state's involvement and interest in the affected contracts, the Court deferred to the

35. *Id.* at 442.

36. The Court recognized a clear trend in that direction: "Where, in earlier days, it was thought that only the concerns of individuals or of classes were involved, and that those of the state itself were touched only remotely, it has later been found that the fundamental interests of the state are directly affected; and that the question is no longer merely that of one party to a contract as against another, but of the use of reasonable means to safeguard the economic structure upon which the good of all depends." *Id.* at 442.

37. 310 U.S. 32 (1940).

38. *Id.* at 38.

39. While the emergency created by the Depression was short-lived, the weakness in the financial system revealed by the emergency remained. The Court found no reason that the legislation should not remain in effect after the passing of the emergency. *Id.* at 39.

40. 326 U.S. 230 (1945).

41. *Id.* at 235. *Cf. Gelfert v. National City Bank*, 313 U.S. 221 (1941) (upholding a permanent, nonemergency statute that allowed a mortgagee to obtain a deficiency judgment only in the foreclosure proceeding, thereby eliminating a substantial remedy available under prior law).

42. 326 U.S. at 233 (quoting *Manigault v. Springs*, 199 U.S. 473, 480 (1905)).

43. 379 U.S. 497 (1965). The decision was noted in 51 A.B.A. J. 371 (1965) and 51 VA. L. REV. 692 (1965).

44. 379 U.S. at 500-01.

45. *Id.* at 516-17.

legislature.⁴⁶ It found that the legislation advanced significant public interest⁴⁷ without affecting the "primary consideration" for which buyers entered into the contracts.⁴⁸

The Court did find, however, that state impairment of municipal bond contracts affected the underlying consideration for bondholders' purchases in *W.B. Worthen Co. v. Kavanaugh*,⁴⁹ in which the Court struck down a statute that substantially altered the mortgage provisions securing the bonds. In fact, the only case in the last century in which the Court has sustained an alteration of a municipal bond contract was *Faitoute Iron & Steel Co. v. City of Asbury Park*.⁵⁰ The Court upheld a statutory provision that permitted agreement by the creditors of a bankrupt municipality to accept less than the full amount of their claims. The city's obligation was thereby discharged, not impaired.⁵¹

In all, the line of decisions beginning with *Blaisdell* raised serious doubts about the capacity of the contract clause to serve as a constitutional guardian of individual contract rights. Despite contract clause challenges, the Supreme Court consistently upheld state police power legislation reasonably addressed to legitimate and vital public concerns.⁵²

The Court in the instant case, by refusing to allow the New Jersey legislature to repeal the covenant it had made with the bondholders, provided reassurance that the "Contract Clause was [not] without meaning in modern constitutional jurisprudence, or that its limitation on state power was illusory."⁵³ In spite of vital state interests in mass transportation and energy conservation, the Court reversed the past trend, failing to find sufficient justification to defer to the legislative discretion in the face of the state's self-serving repeal.⁵⁴

The bondholders' challenge of the 1974 repeal prompted the Court to determine the actual financial injury suffered by the plaintiff. The evidence of

46. *Id.* at 508-09.

47. Specifically, the public had an interest in clearing land titles, eliminating litigation over titles, and promoting effective utilization of the property. *Id.* at 515-16.

48. *Id.* at 514. The redemption rights were not found to be the central motivation for either the buyers' or sellers' decisions. Rather, purchase in hope of discovery of "mineral wealth" appeared to be the controlling consideration. *Id.* at 515.

49. 295 U.S. 56 (1935). The Court felt the alteration to be "an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security." *Id.* at 62. See also *Louisiana v. Pilsbury*, 105 U.S. 278 (1882).

50. 316 U.S. 502 (1942).

51. *Id.* at 511. See note 18 *supra*.

52. See, e.g., *Manigault v. Springs*, 199 U.S. 473 (1905); *Butcher's Union Co. v. Crescent City Co.*, 111 U.S. 746 (1884). See generally Note, *supra* note 22, at 589: "Perhaps its major contribution is an indirect one by incorporating the protection of contractual relationships into the Constitution, the clause gives greater specificity to the broad concept of due process, a specificity which may sometimes be determinative in preventing retroactive application of state laws."

53. 97 S. Ct. at 1515.

54. The Court examined the language and history of the covenant and concluded that it had been "properly characterized as a contractual obligation of the two States." *Id.* at 1516. The covenant provided contract clause protections "as security against repeal" and in return benefitted the states by significantly enhancing the marketability of the Port Authority bonds. *Id.*

the extent of that injury was inconclusive.⁵⁵ The trial court conceded that immediately following the repeal the market price of the bonds was diminished.⁵⁶ The bonds nevertheless retained an "A" rating from the leading evaluation services.⁵⁷ Despite the uncertainty, the Supreme Court concluded that the covenant did limit "the Port Authority's deficits and thus protected the general reserve fund from depletion. . . . Its outright repeal eliminated an important security provision and thus impaired the obligation of the State's contract."⁵⁸

Standing alone, the determination that the obligation was impaired was insufficient to provoke contract clause condemnation.⁵⁹ The Court would not apply a literal reading to the clause. Finding what the Court termed a "technical impairment" was but a prerequisite to the more arduous task of determining whether the impairment was contrary to the Constitution.⁶⁰ Exercise of the police power had to be consistent with the "constitutional limitation of that power,"⁶¹ and even legislation addressed to important public concerns would not insure constitutionality. The permissibility of impairment through exercise of the state's police power was contingent in part on the nature of the contracts involved.⁶²

Noting that the contracts in the instant case were public in nature, the Court immediately distinguished *Blaisdell*. Whereas impairment of private agreements required the existence of a legitimate public purpose,⁶³ state modification of its own agreements generated different concerns.⁶⁴ The Court in the instant case, faced with the latter situation, had to decide whether the 1962 covenant unduly constricted the state's police power. Determination that the 1962 covenant was invalid would have obviated the need to consider the question of the 1974 repeal.

The financial nature of the covenant prevented it from automatically falling within the inalienable police powers, in which event the 1962 law would

55. "The fact is that no one can be sure precisely how much financial loss the bondholders suffered." *Id.*

56. *United States Trust Co. v. New Jersey*, 134 N.J. Super. 124, 180, 338 A.2d 833, 865 (1975).

57. 97 S. Ct. at 1516.

58. *Id.*

59. *Id.* at 1517. *See also* *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. at 473: "But full recognition of the occasion and general purpose of the clause does not suffice to fix its precise scope. . . . [J]udicial decisions . . . put it beyond question that the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula."

60. 97 S. Ct. at 1517.

61. *Id.* (quoting *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 428, 439 (1934)).

62. *Id.*

63. 290 U.S. at 444-45.

64. When the state is a party to an affected contract, the court must first consider whether an earlier legislature has improperly limited the power of the state to act in the future. With either private or public contracts, however, careful scrutiny in the past had generally given way to judicial deference to the legislative wisdom. Once beyond the initial threshold of finding some legitimate state purpose, courts would not delve deeper to determine just how legitimate in fact that purpose was. *See, e.g., City of El Paso v. Simmons*, 379 U.S. 497 (1965); *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934).

have been void ab initio.⁶⁵ Because the covenant was financial, classification of the law under the state's taxing and spending powers was more appropriate, and prior courts had held that a state could bind the future exercise of the taxing and spending power.⁶⁶ Moreover, prior courts had declared legislative impairments of municipal bond contracts unconstitutional.⁶⁷ While the distinction between the taxing and spending powers and police powers was admittedly "formalistic," it provided a framework for the Court's analysis. Determination that the 1962 covenant was valid was not dispositive, however, since financial obligations were nonetheless capable of constitutional impairment.⁶⁸ It remained for the Court to examine the constitutionality of the repeal.

Comparing the instant case with *Faitoute Iron & Steel Co.*,⁶⁹ the Court found the impairment in the present case clearly more serious. Rejecting the notion of the trial court that total impairment was necessary to provoke constitutional sanctions, the Supreme Court proposed that "an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose."⁷⁰ In applying this test, the Court refused to yield to the legislative discretion because the state's self-interest in the contracts made such deference patently inappropriate.⁷¹

While the state concerns were "admittedly important,"⁷² the Court found the repeal unnecessary because less drastic modification of the covenant or alternative means⁷³ could have achieved the same ends.⁷⁴ The Court found

65. 97 S. Ct. at 1518-19.

66. *New Jersey v. Wilson*, 11 U.S. (7 Cranch) 164 (1812) (contract clause prohibited impairment of a grant of a permanent tax exemption). "Any financial obligation could be regarded in theory as a relinquishment of the State's spending power, since money spent to repay debts is not available for other purposes. Similarly, the taxing power may have to be exercised if debts are to be repaid. Notwithstanding these effects, this Court has regularly held that the States are bound by their debt contracts." 97 S. Ct. at 1519.

67. *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935); *Louisiana v. Pilsbury*, 105 U.S. 278 (1882). See text accompanying note 49 *supra*.

68. 97 S. Ct. at 1519.

69. See text accompanying notes 50-51 *supra*.

70. 97 S. Ct. at 1519.

71. *Id.* at 1519-20: "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a state could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all."

72. *Id.* at 1521.

73. Alternative means suggested by the Court included state taxes "to encourage VMT (vehicle miles traveled) reductions while raising revenues to benefit mass transit," elimination of commuter toll discounts, and increases in tolls during peak commuting hours. *Id.* at 1522 n.29.

74. The Court suggested that new revenues might have been directed to subsidize mass transit without substantially reducing the value of the covenant. The covenant would continue to protect the revenues and reserves that historically secured the bonds. The Court also suggested that the formula for computing permitted deficits might have been altered, or procedures for obtaining bondholders' consent to new projects might have been changed to facilitate obtaining that approval. *Id.* at 1522 n.28. Chief Justice Burger, in a concurring opinion, expressly disavowed the suggestion that any of the proposed modifications were constitutional. *Id.* at 1523.

that the repeal was unreasonable because the covenant was passed with full knowledge of the importance and need for mass transit: "these concerns were not unknown in 1962, and the subsequent changes were of degree and not of kind."⁷⁵

The dissenters argued that this conclusion followed from the Court's misplaced emphasis on "related, but peripheral matters" and neglect of the vital state interests advanced by the repeal.⁷⁶ The dissent pointed to the trial court's finding that only minimal damage to the bondholders' interests resulted from the repeal⁷⁷ and noted the present, continued existence of alternative safeguards securing the bonds.⁷⁸ The dissenting Justices were also unconvinced by the readiness of the majority to label the covenant "purely financial,"⁷⁹ since the effect of this artificial distinction was to permit the Court to deviate from the "long history of judicial deference to state lawmaking in the face of challenges under the Contract Clause."⁸⁰ Contract rights have been subordinated to reasonable exercises of the police power, and the dissent saw the state's mass transportation and pollution problem as sufficiently vital to fall within the realm of the reserved powers.⁸¹ The majority's "necessary and reasonable"

75. *Id.* at 1523.

76. *Id.* at 1526. The dissenters accused the majority of failing to confront squarely the factual situation of the instant case. An honest consideration of that situation, they contended, would demonstrate the arbitrary nature of the standard announced by the Court. *Id.* at 1526-27.

77. *Id.* at 1527-29 (citing *United States Trust Co. v. New Jersey*, 134 N.J. Super. 124, 181-82, 194, 196, 338 A.2d 833, 866, 873-74 (1975)).

78. 97 S. Ct. at 1524. Port Authority bonds were still secured by two rigid safeguards. The so-called "1.3 test" prohibited the Authority "from issuing new consolidated bonds unless the best one-year net revenues derived from all of the Authority's facilities equal at least 130% of the prospective debt service for the calendar year during which the debt service for all outstanding and proposed bonds would be at a maximum." Under the "'section 7 certification,' the Authority may not issue bonds to finance additional facilities unless it 'shall certify' that the issue 'will not during the ensuing 10 years or during the longest term of any such bond proposed to be issued, . . . whichever shall be longer, . . . materially impair the sound credit standing of the Authority. . . .'" *Id.*

79. Such a distinction, according to the dissent, rested upon a "conception of state sovereignty that is both simplistic and unpersuasive." *Id.* at 1532 n.15. Contrary to the position of the majority, the taxing and spending powers are among the most important of governmental functions, and cases subsequent to *New Jersey v. Wilson*, 11 U.S. (7 Cranch) 164 (1812), have focused on whether the power in question is an "exercise of the sovereign authority of the State," *Seton Hall College v. Village of South Orange*, 242 U.S. 100, 106 (1916), rather than a power that can be labeled "financial." 97 S. Ct. at 1533 n.15. *See, e.g., New York ex rel. Clyde v. Gilchrist*, 262 U.S. 94 (1923); *Seton Hall College v. Village of South Orange*, 242 U.S. 100 (1916); *Rochester Ry. v. City of Rochester*, 205 U.S. 236 (1907).

80. 97 S. Ct. at 1532. The dissent relied on both a line of cases demonstrating the development of the police power, *id.* at 1530-32, and the *Blaisdell-El Paso* line of contract clause decisions, *id.* at 1535-36, to support its contention that adherence to precedent would have resulted in the Court's yielding to the legislative discretion and upholding the 1974 repeal as a valid exercise of the state's police power. From its analysis of the historical foundation, the dissent concluded that "[i]t need hardly be said that today's decision is markedly out of step with this deferential philosophy." *Id.* at 1536.

81. Three congressional enactments between 1962 and 1974 served as evidence of the recognition of the severity of the problem: Urban Mass Transportation Act of 1964, 49 U.S.C.A. §§1601-1613 (West 1976); Urban Mass Transportation Assistance Act of 1970, 49

test which led to a contrary conclusion was criticized as novel, unprecedented, and unsuited to adjudication of contract clause conflicts.⁸²

The instant case does not depart from prior decisions as radically as the dissent contended. *Blaisdell* is clearly distinguishable. In that case, the contracts were private, the statute was directly addressed to a serious emergency, and the temporary impairment did not affect the integrity of the obligations.⁸³ Any attempt by the dissent to bring the instant case within the scope of the *Blaisdell* emergency cannot adequately deal with the remaining factual differences. Furthermore, the framework utilized by the Court in the instant case was essentially the same as that relied upon in *El Paso*.⁸⁴

The dissent was correct, however, in its indication that the Court in the instant case adopted new standards representing a departure from precedent. The effect of the decision is to increase substantially the burden of the state in demonstrating that the vital public interest to be served by the contractual impairment is reasonable and necessary. The requirement that the state's purpose be achieved in the least drastic manner is a novel test, and modifications that may previously have survived judicial scrutiny will face more rigorous examination. The Court in the instant case offered several less drastic alternatives⁸⁵ but refused to consider their constitutionality.⁸⁶

The departure from deference to the legislative discretion in cases of self-serving impairments also signals increased judicial respect for rights of individual bondholders and puts a greater burden on the state to show the necessity for the desired impairments. Taken together, the requirement that the least restrictive alteration be utilized and the Court's critical attitude toward self-serving modifications by the state indicate that probably nothing short of an emergency would justify legislation impairing contracts. The reluctance of the Court in the instant case to permit modification in the face of the critical mass transit and energy problems lends additional support to this proposition.

The unwillingness of the Court to permit contractual impairment in spite of insufficient evidence of concrete financial injury to the bondholders' interests is also indicative of the Court's concern that the state meet a stricter standard in justifying that impairment. Underlying the majority's opinion is

U.S.C.A. §1601a (West 1976); Clean Air Act, 42 U.S.C.A. §1857 (West 1976). See generally *United States Trust Co. v. New Jersey*, 134 N.J. Super. 124, 167-76, 338 A.2d 833, 858-63 (1975).

82. The dissent maintained that preexisting judicial connotations of the words "reasonable" and "necessary" within a constitutional context rendered them unsuitable for the Court's purpose. Further criticism was warranted, they felt, by the Court's utilization of a "less-restrictive alternative" principle in application of the "necessary" test, and a modified "foreseeability" standard in application of the "reasonable" test. 97 S. Ct. at 1534 n.17.

83. Brief for Appellant at 60.

84. The *El Paso* Court spoke in terms of the reserved power of the state to take "effective and necessary measures" to safeguard public interests, 379 U.S. at 513-14, with recognition of the requisite judicial deference to the legislative determination of what was in fact necessary. *Id.* at 508-09. The Court in both the instant case and *El Paso* would permit reasonable exercises of police power to advance substantial state interests regardless of the effect on contractual obligations.

85. See note 73 *supra*.

86. 97 S. Ct. at 1522 n.28.

the recognition that the 1962 covenant was of genuine significance to the bondholders.⁸⁷ Municipal bonds serve as the principal source of revenue for innumerable state and local government projects. The ability of these tax-exempt bonds to sell at lower than commercial interest rates is partially the result of their reputation as a safe investment.⁸⁸ Accordingly, the 1974 repeal impaired not only the 1962 covenant but also the reputation of municipal bonds as secure investments. Indeed, the recent near collapse of New York City's financial structure may be traced to the city's failure to maintain adequately secured bonds.⁸⁹

The Court was concerned with these underlying considerations for investor interest in the Port Authority bonds. Reliance on the 1962 covenant was central to the purchases of the bondholders, and the Court in effect estopped the state from disregarding that reliance. In the words of Justice Blackmun, "a state cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors."⁹⁰ The state's financial obligation cannot be so easily manipulated.

Clearly, the instant decision revives the contract clause as a viable constitutional provision. Refusing to defer to state legislative discretion, the Court reversed the modern trend of subordinating contractual obligations to police power legislation and thereby established a boundary for the exercise of that power. The real benefactor is the municipal bondholder, who is assured that the pledges securing his investment will not be modified at the state's convenience.

CHARLES V. HEDRICK

87. Certainly the willingness of the Court to overturn the 1974 repeal in spite of substantial uncertainty about the damage occasioned by that action was evidence of the value placed on the covenant by the majority. Evidently, no specific minimum financial loss was necessary to strike down the statute on contract clause grounds.

The effect of the Court's decision in the instant case on the bond prices provides further evidence of the value of the covenant. Older bonds rallied as much as \$20 for every \$1,000 in bonds, and the Port Authority's most recent issues jumped \$17.50 each to \$1,030 bid, \$1,040 offered. *Wall Street J.*, Apr. 28, 1977, at 7, col. 1; *N.Y. Times*, Apr. 28, 1977, at 1, col. 8.

88. *Wall Street J.*, Apr. 29, 1977, at 12, col. 1.

89. *Id.* The New York City municipal bond market was "corroded" by the decision in the early 1960's to issue "moral obligation" bonds which were not backed "by the State's full faith and credit. The slippage . . . became truly serious with the covenant repeal in 1974 and then went downhill rapidly with default of the Urban Development Corp., the collapse of the market for the New York City debt, the Moratorium Act producing a default on \$2.6 billion of New York City notes and the near-collapse of financing for New York State and its 'moral obligation' authorities." *Id.*

90. 97 S. Ct. at 1521.