

**We discussed this issue of retroactivity yesterday. I have done a bit more work on it and discovered that it is more complicated than I realized. I believe that we would have very good arguments if the retroactive application of our act were to be challenged on the ground that it violates the Contracts Clause. I cannot predict how that argument would play out in every case and in every court, however, so I believe we must continue our efforts to make our act as fair and balanced as possible to all concerned. That is not only the best way to ward off a serious Constitutional challenge, but also the best way to prevail if such a challenge is launched.**

This is something I prepared for a Uniform Law Commission project. It may be helpful with this discussion, even though it is somewhat lengthy:

**What follows is an explanation of the Contracts Clause from Wikipedia, and then an explanation of two more recent US Supreme Court cases from the Cornell Law School Legal Information Institute.**

## **Impairing the obligation of contracts\***

No State shall ... pass any ... Law impairing the Obligation of Contracts.

During and after the Revolution, many states passed laws favoring colonial debtors to the detriment of foreign creditors. Federalists, especially [Alexander Hamilton](#), believed that such a practice would jeopardize the future flow of foreign capital into the fledgling United States. Consequently, the Contract Clause, by ensuring the inviolability of sales and financing contracts, encouraged an inflow of foreign capital by reducing the risk of loss to foreign merchants trading with and investing in the former colonies.<sup>[17]</sup>

The clause does not prohibit the federal government from modifying or abrogating contracts. (emphasis added)

During the [New Deal](#) Era, the Supreme Court began to depart from the [Lochner era](#) constitutional interpretation of the [Commerce Clause](#), [Due Process](#), and the Contract Clause. In [Home Building & Loan Association v. Blaisdel](#),<sup>[18]</sup> the Supreme Court upheld a [Minnesota](#) law that temporarily restricted the ability of mortgage holders to [foreclose](#).<sup>[19]</sup> The law was enacted to prevent mass foreclosures during the Great Depression, a time of economic hardship in America.

The kind of contract modification performed by the law in question was arguably similar to the kind that the Framers intended to prohibit, but the Supreme Court held that this law was a valid exercise of the state's [police power](#), and that the temporary nature of the contract modification and the emergency of the situation justified the law.<sup>[20]</sup>

Further cases have refined this holding, differentiating between governmental interference with private contracts and interference with contracts entered into by the government. Succinctly, there is more scrutiny when the government modifies a contract to alter its own obligations.<sup>[21][20]</sup>

## **Modification of private contracts**

The Supreme Court laid out a three-part test for whether a law conforms with the Contract Clause in *Energy Reserves Group v. Kansas Power & Light*.<sup>[22]</sup> First, the state regulation must not substantially impair a contractual relationship. Second, the State "must have a significant and legitimate purpose behind the regulation, such as the remedying of a broad and general social or economic problem."<sup>[23]</sup> Third, the law must be reasonable and appropriate for its intended purpose. This test is similar to [rational basis](#) review.<sup>[20]</sup>

## **Modification of government contracts**

In *United States Trust Co. v. New Jersey*,<sup>[24]</sup> the Supreme Court held that a higher level of scrutiny was needed for situations where laws modified the government's own contractual obligations. In this case, New Jersey had issued bonds to finance the [World Trade Center](#) and had contractually promised the bondholders that the collateral would not be used to finance money-losing rail operations. Later, New Jersey attempted to modify law to allow financing of railway operations, and the bondholders successfully sued to prevent this from happening.<sup>[24]</sup>

\*From Wikipedia [https://en.wikipedia.org/wiki/Contract\\_Clause](https://en.wikipedia.org/wiki/Contract_Clause) retrieved November 1, 2019, checked April 30, 2020 (footnotes omitted)

The Cornell Legal Institute reviews two more recent US Supreme Court cases of interest.\*\*

More important, the Court has been at pains most recently to reassert the vitality of the clause, although one may wonder whether application of the clause will be more than episodic.

“[T]he Contract Clause remains a part of our written Constitution.”<sup>2221</sup> So saying, the Court struck down state legislation in two instances, one law involving the government’s own contractual obligation and the other affecting private contracts.<sup>2222</sup> A finding that a contract has been “impaired” in some way is merely the preliminary step in evaluating the validity of the state action.<sup>2223</sup> But in both cases the Court applied a stricter-than-usual scrutiny to the statutory action, in the public contracts case precisely because it was its own obligation that the State was attempting to avoid and in the private contract case, apparently, because the legislation was in aid of a “narrow class.”<sup>2224</sup>

The approach in any event is one of balancing. “The severity of the impairment measures the height of the hurdle the state legislation must clear. Minimal alteration of contractual obligations may end the inquiry at its first stage. Severe impairment, on the other hand, will push the inquiry to a careful examination of the nature and purpose of the state legislation.”<sup>2225</sup> Having determined that a severe impairment had resulted in both cases,<sup>2226</sup> the Court moved on to assess the justification for the state action.

In *United States Trust*, the Court ruled that an impairment would be upheld only if it were “necessary” and “reasonable” to serve an important public purpose. But the two terms were given restrictive meanings. Necessity is shown only when the state’s objectives could not have been achieved through less dramatic modifications of the contract; reasonableness is a function of the extent to which alteration of the contract was prompted by circumstances unforeseen at the time of its formation. The repeal of the covenant in issue was found to fail both prongs of the test.<sup>2227</sup>

In *Spannaus*, the Court drew from its prior cases four standards: did the law deal with a broad generalized economic or social problem, did it operate in an area already subject to state regulation at the time the contractual obligations were entered into, did it effect simply a temporary alteration of the contractual relationship, and did the law operate upon a broad class of affected individuals or concerns. The Court found that the challenged law did not possess any of these attributes and thus struck it down.<sup>2228</sup>

Whether these two cases portend an active judicial review of economic regulatory activities, in contrast to the extreme deference shown such legislation under the due process and equal protection clauses, is problematical. Both cases contain language emphasizing the breadth of the police powers of government that may be used to further the public interest and admitting limited judicial scrutiny. Nevertheless, “[i]f the Contract Clause is to retain any meaning at all . . . it must be understood to impose *some* limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power.”<sup>2229</sup>

\*\* <https://www.law.cornell.edu/constitution-conan/article-1/section-10/clause-1> Retrieved November 1, 2019. (footnotes omitted).