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The Unskinnable Cat: Debt Reduction, Eminent Domain and the Contract Clause

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THE UNSKINNABLE CAT: DEBT REDUCTION, EMINENT DOMAIN AND THE CONTRACT CLAUSE

INTRODUCTION

"[T]he attempt by legislative devices to shift the misfortune of the debtor to the shoulders of the creditor without coming into conflict with the [Contract Clause] has been persistent and oft-repeated."[1] Indeed, recent United States Supreme Court decisions have opened the door for a new type of "legislative device" that would allow states to circumvent the prohibitions of the Contract Clause by taking contracts through eminent domain, modifying them as desired, and then re-selling the modified contracts back into the market. Although it would appear that neither the Contract Clause nor the Takings Clause individually would prohibit such a scheme, this Article will show that the two clauses are interrelated in such a manner that the Contract Clause prohibitions apply through the Takings Clause to prevent such takings. Furthermore, the same principles that apply in the case of the Contract Clause apply to other constitutional limitations on state power as well, preventing states from using eminent domain as an end-around their constitutional limitations.

A. The Problem of Debt and the Prohibition on Solutions

State and local governments have been faced with the problems associated with over-burdened debtors since well before the ratification of the Constitution.[2] And, as long as is the history of such problems, equally long is the history of government attempts to lighten the debtor's load. Although debtor relief in the form of laws postponing payments or exempting property from execution have been pervasive, some of the more popular and potent attempts at relieving overburdened debtors have come in the form of debt reduction—that is, methods of reducing the principal amount of debt owed by debtors to their creditors.[3] In the effort to relieve debtors, the immediate and substantial relief principal reduction offers is difficult, if not impossible, to match with other forms of relief.

1. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 472 (1934) (Sutherland, J., dissenting).

2. *See id.* at 427–28.

3. *See* BENJAMIN FLETCHER WRIGHT, JR., THE CONTRACT CLAUSE OF THE CONSTITUTION 1–6 (1938).

Since the ratification of our Constitution, however, such government-imposed principal reduction has been faced with a formidable obstacle in the Contract Clause of the Constitution, contained in Article I, Section 10, which prohibits states from enacting laws that impair the obligations of contracts.[4] Debt, being by its nature contractual, falls within the protections of the Contract Clause, and attempts to relieve debtors of their burdens have been invalidated on that ground at nearly every turn since the years immediately following Ratification.[5]

In 2005, however, the effort in the fight for debtor relief was an unexpected beneficiary of the controversial United States Supreme Court decision in *Kelo v. City of New London, Connecticut*.[6] In *Kelo*, the court upheld as a valid public use under the Fifth Amendment's Takings Clause[7] the government's taking of a private residence through eminent domain, even though the property was transferred to another private party as part of an economic development plan.[8] Although this was not the first time the court upheld the taking of private property for the purpose of transferring it directly to another private party,[9] the ability of the government to do so in the name of "economic development," combined with the court's deference to the government in determining what constitutes economic development,[10] appeared to greatly expand the government's ability to use eminent domain in solving economic and social problems.

The ability to take private property as part of an economic plan even though that property ultimately ends up in the hands of another private party provided a potential work-around the prohibitions of the Contract Clause. Specifically, although the government was prevented by the Contract Clause from enacting general laws that reduced debtors' debt principal, if the government could instead take possession of the underlying debt contracts, it could then modify the contractual obligation without implicating the Contract Clause. Because the government would be using eminent domain and not *passing a law*, it seemingly would not violate the Contract Clause's prohibition against passing laws impairing the obligations of contracts. Additionally,

4. U.S. CONST. art I, § 10, cl. 1.

5. One of the earliest decisions on this point appears to be *Champion and Dickenson v. Casey*, which Benjamin Wright notes in his book *The Contract Clause of the Constitution* but was not printed in the reports. WRIGHT, *supra* note 3, at 19. The Rhode Island circuit court in that case struck down as a violation of the Contract Clause a statute giving a debtor three years to pay his debts, during which time he was free from arrests or attachments. *Id.*

6. Kelo v. City of New London, Conn., 545 U.S. 469 (2005).

7. U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

8. *Kelo*, 545 U.S. at 478–90.

9. *See* Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 243–45 (1984).

10. *See Kelo*, 545 U.S. at 483–84.

because the original creditor would no longer own the contract at the time of modification, there would be no impairment of the obligation owed that creditor. The *Kelo* decision makes this plan realistically possible because it would allow the government to re-sell the modified contracts back into the private market, thereby reducing or eliminating the cost to the government in executing the plan. At least that is the theory.

It did not take long for this theory to come to life. When the Great Recession decimated the housing and financial markets, the issue of debtor relief again took center stage. The following describes the circumstances surrounding one proposed plan to use the Contract Clause work-around just described in the context of mortgage relief.

B. The Housing Crisis and A Plan to Provide Mortgage Relief Through Eminent Domain

In 2007, the United States' economy entered the grips of the Great Recession—the worst economic downturn since the Great Depression.[11] "Housing and housing finance played a central role in touching off the financial crisis and the associated recession," and the resulting foreclosures severely damaged communities across the country.[12] Although the housing sector is improving, "strengthening and broadening the housing recovery remains a critical challenge for policymakers, lenders, and community leaders."[13] Roughly 20 percent of mortgage borrowers nation-wide remain underwater, in which the debtor owes more on the mortgage than the underlying home is worth, and "7 percent of mortgages are either more than ninety days overdue or are in the process of foreclosure."[14] National home prices are "30 percent or more below their peaks in many areas."[15] Simply stated, the magnitude of the housing meltdown has overwhelmed the public and private measures that have been made to help avoid foreclosures and enable underwater borrowers to refinance.[16]

The resulting increase in foreclosures has inflicted damage on the national and local economies, as foreclosed properties sit vacant for long periods of time, deteriorating and decreasing in value.[17] This in turn decreases the values of nearby homes, and concentrations of foreclosures seriously damage

11. MARK ZANDI, FINANCIAL SHOCK: GLOBAL PANIC AND GOVERNMENT BAILOUTS-HOW WE GOT HERE AND WHAT MUST BE DONE TO FIX IT 31(2009).

12. Ben S. Bernanke, Chairman, Fed. Reserve Sys., Challenges in Housing and Mortgage Markets 1 (Nov. 15, 2012).

13. *Id.*

14. *Id.* at 2.

15. *Id.*

16. *Id.* at 7. *See also* ZANDI, *supra* note 11, at 256–57.

17. Bernanke, *supra* note 12, at 4.

neighborhoods and communities, "reducing tax bases and leading to increased vandalism and crime."[18] Additionally, the fall in home prices has reduced homeowners' ability to tap their home equity, and "underwater homeowners may be financially unable to move from their current homes."[19]

The housing crisis has hit San Bernardino County, California, particularly hard. As of July 2012, roughly half of the homes in the county were underwater and the unemployment rate stood at nearly 12 percent.[20] Many homes in the area are worth half of what they were in 2007.[21] Adding insult to injury, recession-time pay cuts have resulted in 22.9 percent of households in the county spending at least half of their income on housing.[22] In an effort to ameliorate these homeowners' dire situation and stimulate the local economy, officials in San Bernardino are considering[23] an idea proposed by the private venture capital firm Mortgage Resolution Partners (MRP) that would use eminent domain to buy underwater mortgages, reduce the mortgage obligation to the value of the underlying property, and resell the mortgages to private investors.[24] According to the MRP proposal, homeowners would receive lower monthly payments and would have a better chance of hanging onto their properties.[25] Ideally, according to the MRP plan, the amounts paid by the government for the mortgages and ultimately received on re-sale would be such that taxpayers are not involved and no government deficit is incurred in the transaction.[26] Although only homeowners who are current on their mortgage would be eligible for the program,[27] estimates predict that more than twenty thousand homeowners in San Bernardino County alone could qualify.[28]

San Bernardino, however, is far from the only place considering the eminent domain idea. More than a dozen local governments are considering

18. *Id.*

19. *Id.* at 5.

20. Jennifer Medina, *California County Considers a Rescue Plan for Struggling Homeowners*, N.Y. TIMES, July 15, 2012, at A14.

21. *Id.*

22. Tomoya Shimura, *More than 60 percent of local homes still underwater*, DAILY PRESS (Nov. 9, 2012), http://www.vvdailypress.com/news/home-37577-forbes-collapsed.html.

23. Alejandro Lazo, *San Bernardino County Abandons Mortgage Plan*, L.A. TIMES, Jan. 25, 2013, at B3.

24. Medina, *supra* note 20.

25. *Id.*

26. Robert J. Shiller, *Reviving Real Estate Requires Collective Action*, N.Y. TIMES, June 24, 2012, at B6.

27. Joe Nelson, *Underwater Mortgage Acquisition Proposal Expands to Include Delinquent or Defaulted Homeowners*, SAN BERNARDINO COUNTY SUN (Sept. 6, 2012), http://www.sbsun.com/general-news/20120906/underwater-mortgage-acquisition-proposal-expands-to-include-delinquent-or-defaulted-homeowners (MRP and government officials are considering expanding the program to include delinquent homeowners as well).

28. Medina, *supra* note 20, at A16.

the plan, including Suffolk County, New York, and Chicago, Illinois.[29] And, as the chairman of MRP put it, "if [the plan] works, every mayor of every city is going to want to do this."[30] Although such mayors might face political and constitutional obstacles, the point is clear that there is a potential for the eminent domain plan to impact a huge portion of the national mortgage market.

There are, to be sure, plenty of critics of the idea. The primary economic criticism is that such a plan would chill investment in the mortgage markets, setting a dangerous precedent that would discourage banks from granting loans in the participating areas.[31] The executive vice president of the Securities Industrial and Financial Markets Association similarly predicts that the plan, if successful, would have a major impact on the local mortgage market: "[i]f the government has the ability to abrogate the contract at will and at the expense of the bond holder, the investor is going to do one of two things: require a tremendous premium for the risk they are incurring, or just not invest at all."[32] Such a result would magnify already onerous lending standards, which have tightened substantially since the beginning of the recession and have slowed the housing rebound and impending economic recovery.[33] As a result of these fears, California Representative John Campbell has gone as far as to propose legislation in Congress aiming to stop plans like San Bernardino's by "barring government-linked entities from buying or guaranteeing loans in counties where a local government has used eminent domain to seize a mortgage loan."[34]

On the other side of the debate, those supporting the measure believe it is a valid and appropriate exercise of government power.[35] Steven Gluckstern, the chairman of MRP, notes that "[u]ntil you fix this problem, you can't fix any other problems."[36] Some ask whether there "[can] be any doubt that keeping people in their homes constitutes a legitimate public purpose?"[37] Some

29. Larry Conley, *A Bold Idea to Rescue Underwater Homeowners*, AM. CITY & CTY. (Sept. 25, 2012), http://americancityandcounty.com/finance/bold-idea-rescue-underwater-homeowners.

30. Medina, *supra* note 20, at A16.

31. *See* Alan Zibel, *Eminent Domain Furor Hits Capitol Hill*, WALL ST. J. (Sept. 13, 2012), http://blogs.wsj.com/developments/2012/09/13/eminent-domain-furor-hits-capitol-hill/; Medina, *supra* note 20.

32. Medina, *supra* note 20, at A16.

33. Bernanke, *supra* note 12, at 6–7.

34. Zibel, *supra* note 31 (reporting the introduction of the "Defending American Taxpayers from Abusive Government Takings Act").

35. *Id.* (citing the managing partner of a firm raising private funds for the MRP plan as proclaiming this as "a states' rights issue if there ever was one.").

36. Medina, *supra* note 20, at A16.

37. Joe Nocera, *Housing's Last Chance?*, N.Y. TIMES, July 10, 2012, at A21.

supporters take a more pragmatic approach, concluding that since nothing else is working, perhaps it is time to give the takings plan a try.[38]

Thus, although there is disagreement as to the propriety of the proposed MRP plan, there is certainly a consensus that successful implementation of the plan would have far-reaching consequences for lenders, homeowners, and the broader economy. Additionally, as precedent for plans addressing other types of debt, such as credit card debt, healthcare debt, and student loan debt, the implications of the plan's constitutionality could personally affect virtually every American.

The following discussion more fully outlines the constitutional issue and doctrine, and reaches the conclusion that, although debt-relief takings plans like the MRP plan might appear at first glance to satisfy the individual requirements of the Contract Clause and Takings Clause, when those two clauses are considered in conjunction, the Takings Clause properly incorporates the prohibitions of the Contract Clause to prohibit such takings.

DISCUSSION

A. The Constitutional Issue

The Contract Clause of the federal Constitution is contained in Article I, Section 10, Clause 1 and provides that "[n]o State shall . . . pass any . . . *Law impairing the Obligation of Contracts* . . . ."[39] The Takings Clause is contained in the Fifth Amendment to the federal Constitution and provides that "private property [shall not] be taken for *public use*, without just compensation."[40] The Takings Clause is made applicable to the individual states through the Fourteenth Amendment.[41]

Before looking in more detail at the constitutional doctrine surrounding the Takings and Contract Clauses, it will be beneficial to first outline the constitutional issue presented by the debt-relief takings outlined in the Introduction. This discussion will use the example of mortgage takings since that example is currently being played out in real life with the MRP proposal. However, the reader should note that the analysis and conclusions contained in this discussion are equally applicable to other types of debt contracts.

38. *See, e.g.*, *id.* ("We're four years into a housing crisis. Nothing has worked to stem the terrible tide of foreclosures. It's time to give eminent domain a try."); Medina, *supra* note 20 ("Nobody else is addressing this adequately, and we're still stuck . . . If Washington or the private sector was able to address this, there wouldn't be a need and we wouldn't even have this conversation.").

39. U.S. CONST. art. I, § 10, cl. 1. (emphasis added).

40. U.S. CONST. amend. V. (emphasis added).

41. Kelo v. City of New London, Conn., 545 U.S. 469, 472 n.1 (2005).

Thus, imagine that the country is in the midst of a major housing crisis with home values half of what they were just a few years ago and homeowners trapped in the precarious situation of owing more on their mortgage than their home is worth. A state desiring to ameliorate the negative effects of such underwater mortgage debt might wish to solve the problem by eliminating the underwater debt itself. One way for the state to provide this relief would be to pass a law pegging mortgage principal to the value of the underlying home. Thus, in cases where the value of the home is worth half as much as the outstanding loan, the homeowner's debt would be cut in half. Although certainly effective in eliminating underwater mortgage debt, the plan would be unconstitutional as applied to existing mortgages because it would impair the underlying obligations of the mortgage contract—it literally would eliminate half of the debtor's debt obligation to his creditor.

But passing a general law is not the only tool a state has at its disposal in addressing the problems of its citizens. A state has an inherent police power—in particular, it has the power of eminent domain—which it could use to take the mortgage contracts from creditors and, once in the state's possession, amend them to write down the loan principal to the value of the underlying home. This course of action seemingly avoids two of the problems encountered in passing a general law: (1) the state is not passing a law, so the Contract Clause is not implicated; and (2) there is no impairment of a contract obligation because the creditors no longer own the mortgages at the time of modification. So long as the public use and just compensation requirements of the Takings Clause are satisfied, this takings plan appears to offend neither the Contract Clause nor the Takings Clause.

Furthermore, because the underwater debt is often valued at a steep discount, a takings plan could be designed so that the desired principal reduction could be effected at little or no ultimate cost to the taxpayer.[42] Thus, by applying this takings plan to the mortgages of all homeowners in the state's jurisdiction, the state could achieve through the use of eminent domain virtually the same result as it was prevented from achieving through general legislation.

As the following discussion attempts to show, however, although not apparent from the text of the Constitution, the Contract Clause is implicated through the Takings Clause and, through that Clause, prevents states from using takings plans to circumvent its prohibitions through the use of eminent domain.

42. This article presumes, as apparently does MRP, that such a plan is economically possible.

B. The Constitutional Doctrine

This section sets out a summary of the relevant doctrine relating to the Contract and Takings Clauses. Section 1 takes a fairly comprehensive look at the history and doctrine of the Contract Clause as it relates to private debt relief. More space is allocated to the history of that clause because it is one of the less well known provisions of the Constitution[43] and its purpose and early interpretation play a more significant role in the analysis. A brief summary of the relevant Takings Clause doctrine is then set out in Section 2.

1. The Contract Clause

Article I, Section 10, Clause 1 of the federal Constitution provides that no state shall pass laws impairing the obligations of contracts.[44]

a. The Purpose of the Contract Clause

The history and purpose of the Contract Clause can be thought of as the "reconciliation of majority rule with the security of private property," a fundamental problem in democratic government.[45] The principal cause for the Framers' inclusion of the Contract Clause in the Constitution was the prevalence of debtor-relief legislation in the states following the Revolution.[46] The majority of these debtor-relief laws took the form of tender laws, stay laws, installment laws, and commodity payment laws.[47] Indeed, the record of the events surrounding adoption of the Contract Clause indicates that the Framers viewed tender laws as a particular menace that needed to be dealt with in the Constitution.[48] However, the issue of tender laws had arguably been dealt with in the prohibition against states making anything but gold and silver coin a legal tender in payment of debts.[49] Thus, if the Contract Clause was not to be a mere superfluous afterthought to Article 1, Section 10, Clause 1, it must have encompassed a meaning that applied to the other forms of debtor relief.

Evidence of that broader scope can be found in the words of Luther Martin, speaking before the Maryland House of Delegates, where he lamented that under the Contract Clause states would no longer have the power to

43. *See* James W. Ely, Jr., *Whatever Happened to the Contract Clause?*, 4 CHARLESTON L. REV. 371, 371 (2010).

44. U.S. CONST. art. I, § 10, cl. 1.

45. WRIGHT, *supra* note 3, at xvii.

46. *See id.* at 4.

47. *See id.*

48. *See* 3 THE FOUNDERS' CONSTITUTION 393–96 (Philip V. Kurland & Ralph Lerner, eds., 1987) [hereinafter FOUNDERS' CONSTITUTION]; WRIGHT, *supra* note 3, at 4–6.

49. U.S. CONST. art. I, § 10, cl. 1. Arguably, the prohibition against this major form of debtor relief is why the Contract Clause received little attention in the Constitutional Convention. WRIGHT, *supra* note 3, at 5–6.

authorize debtors to pay in installments or "by delivering up his property to his creditors at a *reasonable* and *honest* valuation."[50] Madison noted a similar scope to the clause in commenting that laws providing for installment payments of debt were "interpositions of the law in private contracts . . . obnoxious to the strongest objections which prevailed against paper money."[51] Admittedly, many of the Framers appear to have confused the Contract Clause with the monetary provisions of Article 1, Section 10, Clause 1.[52] But nevertheless, the little evidence we have of the Framers' thoughts on the Contract Clause shows that at least some believed that its prohibitions applied the other forms of debtor relief such as stay laws and commodity payment laws.[53]

If the Framers' intent as to the scope of the Contract Clause was unclear, they did a better job of expressing it in regards to the clause's absoluteness. When Rufus King first moved to prohibit the states from interfering in private contracts, George Mason complained that "this was carrying the restraint too far"—that events will happen that cannot be foreseen where "some kind of interference will be proper and essential"—and questioned whether it was proper to prevent the states from taking action in such circumstances.[54] Similarly, Luther Martin voted against the Contract Clause because "there might be times of such great public calamities and distress . . . as should render it the duty of a government" to protect its citizens by passing debtor relief laws.[55] He further notes that "[t]he times have been such as to render [debtor relief regulations] necessary in most, or all of the states, to prevent the wealthy creditor and the monied man from totally destroying the poor though even industrious debtor—Such times may again arrive."[56] The Contract Clause thus "lets loose upon [the people] their private creditors . . . without their governments having a power to give them a moment's indulgence, however necessary it might be, and however desirous to grant them aid."[57] Madison admitted that the prohibition might result in such "inconveniences," but that only such a negative on state law could prevent the evasions that might and would be "devised by the ingenuity of the Legislatures."[58]

50. LUTHER MARTIN, GENUINE INFORMATION (1788), *reprinted in* FOUNDERS' CONSTITUTION, *supra* note 48, at 394.

51. WRIGHT, *supra* note 3, at 14 n.29 (quoting Madison, *Writings*, 1865 ed., I, 265).

52. *Id.* at 15.

53. *See id.*

54. RECORDS OF THE FEDERAL CONVENTION, *reprinted in* FOUNDERS' CONSTITUTION, *supra* note 48, at 393.

55. *See* MARTIN, *supra* note 50, at 394.

56. *Id.* (emphasis omitted).

57. *Id.* (emphasis omitted).

58. RECORDS OF THE FEDERAL CONVENTION, *supra* note 54, at 393.

Justice Sutherland, dissenting in *Home Building & Loan Association v. Blaisdell*,[59] sets down a similar history of the Contract Clause. Following the Revolution, the American people found themselves in an impoverished condition and, consequently, incurred substantial indebtedness in order to purchase imported goods otherwise far beyond their purchasing capacity.[60] Many sympathized with debtors who found it impossible to fulfill their obligations, and state laws were passed suspending debts, issuing paper money, and delaying legal proceedings, among other things.[61] As a consequence of such measures, there was "a loss of confidence in the government and in the good faith of the people," and the debt of even those men whose ability to pay was unquestioned could not be negotiated except at a steep discount.[62]

He notes further that, in response to state legislatures' attempts to relieve debtors' plight through enactment of laws interfering with existing contracts, a clause prohibiting states from passing any law impairing the obligation of contracts was adopted in spite of objections that the provision should allow for interference in the event unforeseen circumstances that require such interference.[63] Moreover, after reviewing the commentary surrounding adoption of the Contract Clause, there remains "no reasonable ground" for denying that the clause was meant to foreclose state action impairing the obligation of contracts primarily and especially aimed as relieving debtors in time of emergency.[64] The majority in *Blaisdell* confirmed this history.[65]

b. Early Interpretation and Application of the Contract Clause

Turning to the Supreme Court's treatment of the Contract Clause, there are relatively few cases relating to the types of statutes the Framers had in mind, those involving statutes diminishing private debt obligations.[66] The first

59. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 448 (1934).

60. *Id.* at 454.

61. *See id.*

62. *See id.* at 454–55.

63. *See id.* at 460–61.

64. *Id.* at 465.

65. *See Blaisdell*, 290 U.S. at 427–28 (citing Chief Justice Marshall's statement in *Ogden v. Saunders*). "The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man, touches the interest of all, and controls the conduct of every individual in those things which he supposes to be proper for his own exclusive management, had been used to such an excess by the state legislatures, as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. This mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith. To guard against the continuance of the evil, was an object of deep interest with all the truly wise, as well as the virtuous, of this great community, and was one of the important benefits expected from a reform of the government." *Id.* at 428.

66. *See* WRIGHT, *supra* note 3, at 101.

decision involving such a statute was *Sturges v. Crowninshield*,[67] involving a state bankruptcy act.[68] The act at issue in that case discharged the debtor of his liabilities for any debt previously contracted upon surrender of his property.[69] Needing to first define the obligation of the contract, the court noted that a contract is an agreement in which a party undertakes to do a particular thing, and that undertaking is the obligation of his contract.[70] Thus, when a contract binds a party to pay a sum of money on a particular day, any law that releases a part of the obligation to pay that sum necessarily impairs it.[71] The court disagreed with the debtor's argument that a contract can only bind a man to pay the full extent of his property: "it is not true that the parties have in view only the property in possession when the contract is formed, or that its obligation does not extend to future acquisitions."[72] To the contrary, because "industry, talents, and integrity, constitute a fund which is as confidently trusted as property itself," the release of future acquisitions from contract liability is an impairment of the contract.[73] It was no answer that the Constitution did not explicitly prohibit states from passing bankruptcy laws; the principle set down was the inviolability of contracts, which was "to be protected in whatever form it might be assailed."[74]

If the Framers' intent regarding the scope of the contract clause was unclear, the Supreme Court in *Sturges* attempted to clarify. Recall that the main debtor relief efforts at the time the Constitution was drafted consisted of tender laws, installment and stay laws, and commodity payment laws. The court found that the Contract Clause could not have been intended to prevent paper money, for that goal was expressly provided for by prohibiting states from emitting bills of credit.[75] Neither could it be intended to prevent states from enabling debtors to discharge their debts with property of lesser value, for that prohibition was also expressly accomplished by requiring that nothing but

67. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819).

68. WRIGHT, *supra* note 3, at 47–48. Note that at the time of this case there was no federal bankruptcy law, leaving states free to enact their own bankruptcy statutes so long as such statutes were otherwise consistent with the federal Constitution. *Sturges*, 17 U.S. at 196–97.

69. *Sturges*, 17 U.S. at 197.

70. *See id.*

71. *Id.* at 197–98.

72. *Id.* at 198.

73. *Id.*

74. *Id.* at 199–200. The Court also briefly notes the distinction between the obligation of a contract and the remedy given to enforce it. This distinction is more fully addressed in *Bronson v. Kinzie*, 42 U.S. (1 How.) 311, 315–18 (1843). Note that the remedy being discussed in *Sturges* was imprisonment for life for failure to pay a debt. *Sturges*, 17 U.S. at 200–01. It is hard to disagree with the Court's reasoning that releasing a debtor-prisoner from confinement does not impair his obligation to pay the underlying debt.

75. *Sturges*, 17 U.S. at 204.

gold and silver be made a tender payment of debts.[76] Thus, the court reasoned, if the Framers intended to address only the remaining issue of laws delaying the payments of debts, then they would have expressly forbidden those laws as they did with the tender laws and commodity payment laws.[77] In any event, they would not have attempted to prohibit laws allowing delayed payments by using the provision "no state shall pass any law impairing the obligation of contracts," for "no men would use terms embracing a whole class of laws for the purpose of designation a single individual of that class."[78] Thus, the Contract Clause is properly interpreted as encompassing all laws impairing the obligations of contracts, including bankruptcy laws.[79] For the Framers knew that the same mischief might be effected by other means; that it was necessary not only to prohibit the particular means of the day, but also "to prohibit the use of any means by which the same mischief might be produced."[80]

The Contract Clause decisions following on the heels of *Sturges* added relatively little substance to the court's treatment of private contract debts. In *McMillan v. McNeill*,[81] the Supreme Court applied the *Sturges* rule in finding unconstitutional a bankruptcy law that, although enacted before the date of contract, discharged a debt contracted in a different state.[82] In *Ogden v. Saunders*,[83] the court limited application of the Contract Clause to retrospective laws, finding an obligation impaired only when contracted before enactment of the relevant statute.[84] The court's holding thus limited *McMillan* to those situations where one state attempted to impair the obligations of contracts entered into in another state.[85] The *Ogden* and *McMillan* holdings are entirely consistent under the principle that a contract obligation encompasses only those obligations that are consistent with the law at the time of contract.[86]

76. *Id.* at 204–05.
77. *Id.* at 205.
78. *Id.*
79. *Id.* at 206–08.
80. *Id.* at 206.
81. McMillan v. McNeil, 17 U.S. (4 Wheat.) 209 (1819).
82. *Id.* at 212–13.
83. Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827).
84. *Id.* at 262.
85. *Id.* at 272.
86. *Id.* at 257–58. Chief Justice Marshall dissented, lamenting that the court's construction of the Contract Clause turned it into a mere prohibition against retrospective laws. *Id.* at 335 (Marshall, J., dissenting). The Chief Justice's complaint is unjustified, of course, since the court's holding requires no more than a prohibition against retrospective laws *that impair the obligation of contracts*. This latter construction is logical considering that the Framers viewed the prohibition against *ex post facto* laws as applying only to criminal cases and rejected a proposed general prohibition on retrospective laws in favor of the prohibition against the obligation of contracts. *See* RECORDS OF THE FEDERAL CONVENTION, *supra* note 54, at 393.

After the court established that the Contract Clause applied only retrospectively, it turned its attention to elaboration of another issue that had thus far been left unexamined—namely, the extent to which a remedy may be modified without impairing the obligation of the contract. In *Bronson v. Kinzie*, the Supreme Court found unconstitutional as applied to previously entered contracts two Illinois laws designed to protect mortgagors: the first providing debtors twelve months to redeem their mortgaged homes, provided they repay the purchase money and 10 percent interest; the second preventing sales of the mortgaged property unless there was a bid at the sale at least equal to two-thirds of something akin to fair market value.[87] The court found that if a law passed after execution of the contract does nothing more than change the remedy upon the contract, then such a law would not violate the Contract Clause of the Constitution; and this is so even when the new remedy "may to some degree render the recovery of debts more tardy and difficult."[88] On the other hand, when a law "so change[s] the nature and extent of existing remedies as to materially impair the rights and interests of the owner," it will be held unconstitutional, for there is no substantial difference between a law abrogating contracts and one that takes away "all remedy to enforce them, or encumbers [the remedy] with conditions that render it useless or impractical to pursue it."[89] The laws in question deprived the mortgagee of the benefit of the security he bargained for, by either rendering sale of the property impossible or, if not impossible, "unsalable for anything like its value."[90]

On the same principles as those in *Bronson*, similar statutes were likewise found in violation of the Contract Clause in *Gantly's Lessee v. Ewing*[91] and *Howard v. Bugbee*.[92] In discussing when modification of remedies goes too far, the Supreme Court in *Ewing* noted that an act directly prohibited by the Contract Clause could not be accomplished indirectly: if the state could require that property executed upon for enforcement of a contract be sold at a certain price, so could it declare that the property must bring its entire value or not be

87. Bronson v. Kinzie, 42 U.S. (1 How.) 311, 312 (1843). The value determination in the second law was made by three "householders," each "fairly and impartially" valuing the property after being duly sworn. *Id.*

88. *Id.* at 315–16. For example, a law may shorten the statute of limitations for bringing claims on a contract, or provide exemptions from execution on judgments for the necessities of life such as farming implements, tools, household furnishings, and clothing. *Id.* at 315.

89. *Id.* at 316–17.

90. *Id.* at 319–20.

91. Gantly's Lessee v. Ewing, 44 U.S. (3 How.) 707, 717 (1845) (invalidating retrospective application of a law prohibiting the sale of property on execution for less than half its cash value at the time of sale).

92. Howard v. Bugbee, 66 U.S. (1 Black) 461, 464 (1860) (invalidating retrospective application of a law "authorizing a judgment creditor of the mortgagor, or of his estate, at any time within two years after the sale under a mortgage, to redeem the land from the" purchaser on paying the purchase money plus interest).

sold at all, which in effect would be "impairing or defeating the obligation of the contract under the guise of regulating the remedy."[93]

As Wright points out in his book, nearly all of the acts in the cases from *Bronson v. Kinzie* forward were intended to aid those burdened with debts assumed in more prosperous years and, consequently, the *Ogden* prohibition against retroactive debtor relief laws was in these cases of more consequence than in the case of bankruptcy statutes, since the laws were applicable exclusively to periods following a depression.[94] He further notes that those acts did "not attempt to abolish the debt, to reduce it, nor permit payment in depreciated currency" or property.[95] Instead, they merely attempted "to postpone or stay the time of execution or of actions for the foreclosure of mortgages, to permit payments in installments, to extend the time of redemptions, or in some other way to make the burden of the debtor easier."[96] In any event, there were few cases of this kind, and the rule of *Bronson v. Kinzie* remained settled doctrine until *Blaisdell* in 1934.[97]

c. A Shift Toward the Modern Interpretation

The case of *Home Building & Loan Association v. Blaisdell*[98] is considered a turning point towards a more lenient Contract Clause doctrine.[99] The statute at issue in *Blaisdell* was enacted in a time of great economic hardship and extended the debtor's period of redemption following sale of his home pursuant to the creditor's contractual power of sale.[100] The extension did not impair the amount of indebtedness, required the debtor to pay rent and interest during the extension, and preserved the creditor's right to a deficiency judgment should the debtor fail to redeem the property.[101] Thus, the creditor

93. *Gantly's Lessee*, 44 U.S. at 717.

94. WRIGHT, *supra* note 3, at 104–05.

95. *Id.* at 68–69.

96. *Id.* at 69.

97. *Id.* at 71.

98. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 398 (1934).

99. *See* Douglas W. Kmiec & John O. McGinnis, *The Contract Clause: A Return to the Original Understanding*, 14 HASTINGS CONST. L. Q. 525, 541–43 (1987) ("In *Home Building & Loan Association v. Blaisdell*, the Court turned the meaning of the contract clause on its head. . . . [T]he Court adopted a very lenient standard of review of debtor relief legislation . . . ."). Wright takes a less dramatic view of the case: "*Blaisdell* . . . appears . . . now to have decided merely the very narrow question of the validity of a particular statute under the specific circumstances there existing." WRIGHT, *supra* note 3, at 119. "So far as any general rule may be said to have emerged, it is merely an apparently limited extension of [previously established principles]." *Id.* In any event, *Blaisdell* "is regarded as the leading case in the modern era of Contract Clause interpretation." U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 15 (1977).

100. *Blaisdell*, 290 U.S. at 423–26.

101. *Id.* at 425.

was secured the equivalent of possession during the extended period of redemption.[102]

Turning to its analysis of the Contract Clause issue, the Supreme Court noted the familiar principle that the Contract Clause "is not to be read with literal exactness like a mathematical formula."[103] Instead, looking to the its past Contract Clause decisions for guidance, the court first focused on the distinction between the modification of remedies and the impairment of obligations, finding that the test has become essentially one of reasonableness.[104] The court distinguished its past decisions invalidating statutes as obligation impairments, finding none of those cases applicable to the circumstances in which the state attempted to compensate the party whose interest was affected.[105]

In addition to the obligation-remedy distinction, the court noted that state power, including the power of eminent domain, is an implied part of every contract.[106] Therefore, "the question is not whether the legislative action affects contracts incidentally . . . but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."[107] Although the Constitution would preclude a state from adopting as its policy the repudiation of debts, the destruction of contracts, or the denial of means to enforce them, the state may constitutionally exercise its police power "in directly preventing the immediate and literal enforcement of contractual obligations, by a temporary and conditional restraint."[108] Importantly, however, any reserved state power read into contracts "must be consistent with the fair intent of the constitutional limitation of that power"; "[t]he reserved power cannot be construed so as to destroy the limitation," just as the limitation may not be construed so as to destroy the essential aspects of the reserved power.[109]

102. *Id.*

103. *Id.* at 428.

104. *Id.* at 428–31. Wright also points out that "[the remedy-obligation distinction] amounts to saying that the change in the remedy must be a reasonable one." WRIGHT, *supra* note 3, at 105.

105. *Blaisdell*, 290 U.S. at 434.

106. *Id.* at 435–36 (finding that "[t]he policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while, a government which retains adequate authority to secure the peace and good order of society."). Note, as discussed *infra*, that the reference to contracts being subject to the state's power of eminent domain is not referring to the court's ability to take the actual contracts through eminent domain, although that power exists as well. Instead, it is referring to cases where the state has attempted to exercise eminent domain in a manner that affected the property underlying the contract, usually resulting in frustration of the contract.

107. *Id.* at 438.

108. *Id.* at 439–40.

109. *Id.* at 439.

Applying the foregoing to the facts of that case, the court in *Blaisdell* upheld the statute against the Contract Clause challenge primarily on the basis that it was enacted in a time of economic emergency, was temporary in nature, and was conditioned to protect the creditors' interests.[110] Significantly, the court found that "the integrity of the mortgage indebtedness [was] not impaired,"[111] a characteristic common to all of the debtor relief statutes that have been upheld by the court.

In *W.B. Worthen v. Thomas*,[112] decided less than five months after *Blaisdell*, the Court had a chance to further define its holding in that case in the context of a retrospective application of a state statute exempting insurance proceeds from the payment of debts.[113] As in *Blaisdell*, the state attempted to justify the statute on the grounds that it was enacted in response to an economic emergency.[114] As an initial matter, the court repeated a principle laid down in one of the first Contract Clause cases: that future acquisitions are liable for contract debts and the release of such acquisitions from liability impairs the contract's obligation.[115] Furthermore, responding to the state's emergency justification, the court distinguished *Blaisdell* and found that the fact that the statute was enacted to respond to economic emergency was not a sufficient answer in and of itself; although the state's reserved powers to respond to public calamity constitute part of the contract, such reserved powers must be construed in harmony with the limitations of the Contract Clause.[116] This holding precludes a construction of the Constitution that would permit a state to repudiate debts, and requires that a state, when meeting the needs of a public disaster through statutes impacting the enforcement of existing contracts, must limit its action "by reasonable conditions appropriate to the emergency."[117] The court found that a statute placing insurance money beyond the reach of existing creditors without limit is neither temporary nor

110. *Id.* at 444–47. Justice Sutherland provided a strong dissent in the *Blaisdell*, which one commentator has noted "cannot fully be answered, save by reference to principles not discussed in [the Court's previous decisions]." WRIGHT, *supra* note 3, at 111. Justice Sutherland, referring to the majority's belief that an obligation-impairing law could be upheld on the basis of economic emergency, noted that, "with due regard for the processes of logical thinking, it legitimately cannot be urged that conditions which produced the rule may now be invoked to destroy it." *Blaisdell*, 290 U.S. at 472 (Sutherland, J., dissenting).

111. *Blaisdell*, 290 U.S. at 445.

112. W.B. Worthen Co. v. Thomas, 292 U.S. 426 (1934).

113. *Id.* at 431.

114. *Id.* at 432.

115. *Id.* (quoting Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819)).

116. *Id.* at 432–34.

117. *Id.* at 433.

conditional.[118] And on that ground, the statute was held unconstitutional as a violation of the Contract Clause.[119]

d. The Court's Recent Contract Clause Pronouncements

Had the foregoing comprised the entirety of the Supreme Court's Contract Clause doctrine, state laws directly reducing debt obligations would undoubtedly come squarely within the Contract Clause's prohibitions. However, in a recent series of cases the court appears to have qualified somewhat the prohibitions of the Contract Clause.[120] In these later cases the court has found that, in applying the Contract Clause, determining whether there has been a substantial impairment of a contract obligation is only the first step in the analysis.[121] Then "the severity of the impairment measures the height of the hurdle the state legislation must clear," with only severe impairments requiring "careful examination of the nature and purpose of the state legislation."[122] In this analysis, the limitations of the Contract Clause must be reconciled with the state's sovereign power to safeguard the welfare of its citizens, and the court will "properly defer to legislative judgments as to the necessity and reasonableness of the particular measure."[123]

Nevertheless, the court has in these cases continued to reiterate some of its fundamental Contract Clause principles: "the Contract Clause limits otherwise legitimate exercises of state legislative authority, and the existence of an important public interest is not always sufficient to overcome that limitation";[124] "whatever is reserved of state power must be consistent with the

118. *W.B. Worthen Co.*, 292 U.S. at 434.

119. *Id.* For a similar result and reasoning, see W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935).

120. *See* U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1 (1977); Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978); Energy Reserves Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400 (1983); Exxon Corp. v. Eagerton, 462 U.S. 176 (1983); Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470 (1987).

121. *See Allied Structural Steel Co.*, 438 U.S. at 244–45; *U.S. Trust Co. of N.Y.*, 431 U.S. at 21.

122. *Allied Structural Steel Co.*, 438 U.S. at 245. The Court in *Allied Structural Steel* goes on to say that "[t]he severity of an impairment of contractual obligations can be measured by the factors that reflect the high value the Framers placed on the protection of private contracts." *Id.*

123. *Kan. Power & Light Co.*, 459 U.S. at 413 (quoting *U.S. Trust Co. of N.Y.*, 431 U.S. at 22–23).

124. *U.S. Trust Co. of N.Y.*, 431 U.S. at 21. *See also Allied Structural Steel Co.*, 438 U.S. at 242 ("If the Contract Clause is to retain any meaning at all, however, it must be understood to impose *some* limits upon the power of the State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power."); *Keystone Bituminous Coal Ass'n*, 480 U.S. at 505 ("Of course, the finding of a significant and legitimate public purpose is not, by itself, enough to justify the impairment of contractual obligations.").

fair intent of the constitutional limitation of that power";[125] "[t]he scope of the state's reserved power depends on the nature of the contractual relationship with which the challenged law conflicts";[126] "private contracts are not subject to unlimited modification under the police power";[127] and, perhaps most importantly, "[a] state could not adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them."[128] Thus, although the court in some circumstances will now weigh the contractual impairment against the state's interest in providing for the welfare of its citizens, the Contract Clause undoubtedly limits the scope of the states' sovereign police powers.

These more recent Contract Clause decisions, although seemingly confused at times,[129] appear to open the door for the possibility that legislation providing for principal reduction might be upheld in certain circumstances. However, these cases have not involved statutes of the type the Contract Clause was designed to address—debt reduction or other debtor relief laws aimed at private contracts[130]—and such laws are almost certainly still prohibited or allowed only when conditioned and temporary.[131] In any event,

125. *U.S. Trust Co. of N.Y.*, 431 U.S. at 21 (quoting Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 439 (1934)).

126. *Id.* at 21–22. Note that aside from the historical and doctrinal differences associated with debt obligations versus other types of contractual obligations, simple reason would seem to call for a different treatment in the two types of contracts as well. For instance, in *Kansas Power & Light Co*, the statute merely impaired the price term of the parties' supply contract. *Kan. Power & Light Co.*, 459 U.S. at 403–10. Changes in the price one must pay to receive goods in the future, while not insignificant, are of a fundamentally different nature than those occurring when one party has already performed—has already provided goods or money—and *then* the other party is relieved of performance. Thus, one characteristic that justifies special treatment of debt obligations is that it is always the case that one party has already performed by delivering to the other the loaned money or goods.

127. *U.S. Trust Co. of N.Y.*, 431 U.S. at 22. *See also Allied Structural Steel Co.*, 438 U.S. at 244 ("[a state's sovereign] power has limits when its exercise effects substantial modifications of private contracts.").

128. *U.S. Trust Co. of N.Y.*, 431 U.S. at 22 (quoting *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. at 439).

129. Some would even describe the Court's more recent decisions as incoherent. *See* Kmiec & McGinnis, *supra* note 99, at 546–52 (finding the Court's newer approach to the Contract Clause misguided, unprincipled, and incoherent).

130. *See* Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 502–03 (1987) ("The context in which the Contract Clause is found, the historical setting in which it was adopted, and our cases construing the Clause, indicate that its primary focus was upon legislation that was designed to repudiate or adjust pre-existing debtor-creditor relationships that obligors were unable to satisfy.").

131. *See* W.B. Worthen Co. v. Thomas, 292 U.S. 426, 433–34 (1934). The Court in *Kansas Power and Light Co.* remarks that "since *Blaisdell*, the Court has indicated that the public purpose need not be addressed to an emergency or temporary situation." *Kan. Power and Light Co.*, 459 U.S. at 412. However, the two cases it cites for that proposition do not involve statutes

the court has never upheld a law retroactively reducing debt principal[132] and, combined with the court's prior cases invalidating such laws[133] and continued pronouncements that states may not adopt laws for the repudiation of debts, it seems unlikely to do so under its current Contract Clause doctrine. After all, "the Contract Clause remains a part of the Constitution. It is not a dead letter."[134]

2. The Takings Clause

The Fifth Amendment to the federal Constitution, applicable to the states through the Fourteenth Amendment,[135] provides that the government cannot take private property for public use unless it pays the owner just compensation.[136] For purposes of the Fifth Amendment, contracts are property.[137]

In the case of *Kelo v. City of New London, Connecticut*, the Supreme Court upheld against a Takings Clause challenge a government taking of a private residence in furtherance of a plan of economic redevelopment.[138] In doing so, the court reiterated its position that it interprets the "public use" requirement of the Takings Clause to mean "public purpose," and that it is not determinative that the public would not own or actually use the property.[139] Thus, it is the taking's purpose, not its mechanics, that matters in determining whether the public use requirement is met.[140] Furthermore, in answering the question of whether the government's plan served a public purpose, the court does not consider the individual taking in isolation, but looks to the government's plan as a whole.[141] Additionally, the court will defer to legislative judgment, "affording legislatures broad latitude in determining what public needs justify

aimed at private debt obligations. *See* U.S. Trust Co. of N.Y. v New Jersey 431 U.S. 1 (1977); Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940).

132. There have been cases limiting deficiency judgments in the case of "unconscionably" low foreclosure sale prices, but such cases do not sanction a reduction in debt principle; to the contrary, these cases and cases like them ensure that the creditor receives payment in full, but not more. *See* Gelfert v. Nat'l City Bank, 313 U.S. 221, 234–35 (1941).

133. *See, e.g.*, Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819); McMillan v. McNeil, 17 U.S. (4 Wheat.) 209 (1819).

134. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 241 (1978).

135. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 231 (1984).

136. U.S. CONST. amend. V. ("No person shall [. . .] be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.").

137. *See* Omnia Commercial Co. v. U.S., 261 U.S. 502, 508 (1923).

138. Kelo v. City of New London, Conn., 545 U.S. 469 (2005).

139. *Id.* at 478–80.

140. *Id.* at 482. (quoting Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 244 (1984)).

141. *Id.* at 484.

the use of the takings power."[142] Nevertheless, the government will not be allowed to exercise its power of eminent domain under the mere pretext of providing a public purpose when its actual purpose is illegitimate.[143] Thus, the court accordingly found that a taking in pursuance of the government's economic development plan, whereby the Government took a private residence and transferred it to a private developer, "unquestionably" served a public purpose satisfying the requirements of the Takings Clause.[144]

The *Kelo* decision relied heavily on two of the court's other recent Takings Clause decisions, *Hawaii Housing Authority v. Midkiff* and *Berman v. Parker*.[145] In *Berman v. Parker*, the court upheld against a Takings Clause challenge the taking of property pursuant to an anti-blight redevelopment plan.[146] In determining whether the government action satisfied the public use requirement of the Takings Clause, the court noted that it was "[dealing] . . . with what traditionally has been known as the police power."[147] The definition of the state's police power is "essentially the product of legislative determinations addressed to the purposes of government," and, "[s]ubject to specific constitutional limitations, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive."[148] And, these principles admit "of no exception merely because the power of eminent domain is involved."[149] Thus, once the object is within the authority of the legislature, "the right to realize it through the exercise of eminent domain is clear. For the power of eminent domain is merely a means to the end."[150]

In *Hawaii Housing Authority v. Midkiff*, the court upheld a law aimed at reducing the concentration of fee simple ownership in Hawaii, whereby that state took the title to real property from lessors and transferred it to the lessees.[151] The court reiterated the principles set out in *Berman* and found that "[t]he 'public use' requirement is thus conterminous with the scope of a sovereign's police powers."[152] The court held the taking within the "public use" requirement of the Takings Clause, finding that "when the legislature's

142. *Id.* at 480, 483.

143. *Id.* at 478.

144. *Kelo*, 545 U.S. at 484.

145. *Id.* at 480–82.

146. *Berman v. Parker*, 348 U.S. 26 (1954). Note that although this case was set in the District of Columbia, the court's analysis is framed by "the legislative powers which a state may exercise over its affairs." *Id.* at 31. *Midkiff* later applies the *Berman* rules to a purely state-law matter. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 239 (1984).

147. *Berman*, 348 U.S. at 32.

148. *Id.*

149. *Id.*

150. *Id.* at 33.

151. *Midkiff*, 467 U.S. at 231–32.

152. *Id.* at 239–40.

purpose is legitimate and its means are not irrational," the court will find the public use requirement satisfied.[153]

Thus, when *Kelo* is read in light of *Midkiff* and *Berman*, as long as the government acts rationally and within its police powers, judged with broad deference to the legislature, then the court will uphold as a public use government action that the government believes will provide appreciable benefits to the community.[154]

C. The Interaction Between Eminent Domain and the Contract Clause

A state's power of eminent domain applies as equally to contracts as to other forms of property; "the sovereign right of the government is not less because the property affected happens to be a contract."[155] Thus, so long as the state is properly exercising its eminent domain power, it may take contracts upon the payment of just compensation. The question becomes, then, what is the proper exercise of a state's eminent domain power?

1. Eminent Domain is Confined to the State's Police Power

As noted above, when discussing whether state takings are proper as public uses within the requirements of the Takings Clause of the Fifth Amendment, the Court notes that it is dealing with "what traditionally has been known as the police power."[156] Indeed, the Court has found that, in the context of the Takings Clause, "public use" is "conterminous with the scope of a sovereign's police powers."[157] The definition of that police power is the product of legislative determinations as to the purposes of the government, and "when the legislature has spoken, the public interest is declared in terms well-nigh conclusive."[158] Further, "this principle admits of no exception merely because the power of eminent domain is involved."[159]

However, as broad as the foregoing definition might appear, a state's police power is nonetheless subject to constitutional limitations, and only once the object is within the authority of the legislature is there a right to realize it through eminent domain.[160] This is so because the "power of eminent domain is merely the means to an end."[161] Ultimately, then, a state may properly use its

153. *Id.* at 242–43.
154. *See* Kelo v. City of New London, Conn., 545 U.S. 469, 483–84 (2005).
155. Omnia Commercial Co. v. U.S., 261 U.S. 502, 508–09 (1923).
156. Berman v. Parker, 348 U.S. 26, 32 (1954); *Midkiff*, 467 U.S. at 239.
157. *Midkiff*, 467 U.S. at 240; Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1014 (1984).
158. *Berman*, 348 U.S. at 32; *Midkiff*, 467 U.S. at 239.
159. *Berman*, 348 U.S. at 32; *Midkiff*, 467 U.S. at 240.
160. *Midkiff*, 467 U.S. at 240.
161. *Berman*, 348 U.S. at 33.

power of eminent domain only in pursuit of those objectives that would justify the enactment of general legislation pursuant to its police power.

2. The Contract Clause Limits a State's Police Power, and in Turn Its Power of Eminent Domain

The court's Takings Clause cases have discussed "public use" in the context of determining whether a state action, otherwise constitutionally unobjectionable, comes within the state's police power: the "role for courts to play in reviewing a legislature's judgment as to what constitutes a public use . . . is 'an extremely narrow' one, . . . [requiring] deference to the legislature . . . '*until it is shown to involve an impossibility*.'"[162] But it is clear that rationality is not the only limit on the police power; the court's Contract Clause doctrine makes that clear. Thus, the Court in these cases has not been addressing the constitutional limits on the police power—because they have not been implicated—but has instead been determining the general breadth of that inherent power. Thus, if the state's police power is thought of as a basket of objectives, the court has simply been determining which state actions are included in the basket—it has been determining which objectives fall within the realm of public safety, public health, morality, peace and quiet, law and order, and the public welfare in general.[163] But in focusing on the breadth of the police power in general, the court has overlooked the specific constitutional limitations on state action otherwise within that power.

The Contract Clause is one such limitation.[164] Although the state may not contract away its police powers[165] and parties cannot remove themselves from the state's police powers through contract,[166] those principles certainly do not lead to the conclusion that the Contract Clause is no restriction on the state's police powers in general—and the power of eminent domain in particular—when those powers are exercised against contracts. The contracting parties—either public or private—are not the source of the relevant restriction on the state's powers; it is the federal Constitution. And that restriction prohibits states from passing laws impairing the obligation of contracts.[167]

It is appropriate that the government's use of eminent domain is restricted to the scope of its police powers, which is in turn restricted by the Contract

162. *Midkiff*, 467 U.S. at 240 (emphasis added) (quoting *Berman*, 348 U.S. at 32; Old Dominion Land Co. v. U.S., 269 U.S. 55, 66 (1925)).

163. *See Berman*, 348 U.S. at 32.

164. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978).

165. Pa. Hosp. v. Philadelphia, 245 U.S. 20, 23 (1917).

166. Hudson Cnty. Water Co. v. McCarter, 209 U.S. 349, 357 (1908); Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 503–04 (1987).

167. U.S. CONST. art. I, § 10, cl. 1; Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 439 (1934) ("[State power] cannot be construed to destroy the [constitutional limitation imposed by the Contract Clause].").

Clause of the federal Constitution. It would be anomalous for the Framers to have prohibited the states from impairing contract obligations through general law but allowed them to do so through the use of eminent domain. This is especially so in light of the fact that, until the public use and compensation requirements of the Fifth Amendment were applied to the states by the Fourteenth Amendment in 1868, the Contract Clause was the only check on the states' power in this regard.[168]

As is the case today, at the time the Contract Clause was drafted much of the relevant debt was valueless or steeply discounted.[169] Thus, regardless of whether compensation was constitutionally required, the states' ability to use eminent domain to affect the desired debtor relief would have rendered the Contract Clause a nullity. The Framers were not blind to this possibility; to the contrary, Madison put it bluntly when he said that only a negative on the states' power could secure contract debts from "[the evasions that] might and would be devised by the ingenuity of the Legislatures."[170] Thus, it is clear that the Framers, ever concerned with securing minority property rights from majority abuses,[171] would never have prohibited contract impairment laws of general application but allowed states to obtain the same ends through means applied to a specific subset of the population.[172] To the contrary, the Framers viewed the Contract Clause as a complete solution to the problem of debt

168. *See Keystone Bituminous Coal Ass'n*, 480 U.S. at 502 ("Prior to the ratification of the Fourteenth Amendment, it was Article I, § 10, that provided the primary constitutional check on state legislative power."). Note that it is no answer to this line of reasoning that at the time of the framing of the Constitution the Fourteenth Amendment did not yet apply the public use requirement to the states' takings power, for the power of eminent domain was inherently subject to a public use requirement and the Fifth and Fourteenth Amendments are more properly considered as merely imposing the requirement of compensation, which not all states had required at the time. *See* Proprietors of Charles River Bridge v. Proprietors of Warren Bridge, 36 U.S. (11 Pet.) 420, 458–59 (1837) ("It is admitted that the right of eminent domain is an incident of sovereignty, and cannot be alienated. And it is also admitted, that all the property of the citizens of the state is liable to the exercise of this paramount authority. No matter by what title it is held, it is all alike subject to be taken *for public use*. The exercise of this power, however, is restricted by an express provision in the state constitution; that compensation shall be made. This fundamental law is inserted in the constitution of the United States, as well as in that of *many* of the states; and the following cases show how fully this principle has been recognised and acted upon, by the judicial tribunals of the country.") (emphasis added).

169. *See Blaisdell*, 290 U.S. at 455 (Sutherland, J., dissenting) ("Bonds of men whose ability to pay their debts was unquestionable could not be negotiated except at a discount of 30, 40, or 50 per cent.").

170. RECORDS OF THE FEDERAL CONSTITUTION, *supra* note 54, at 393.

171. *See* WRIGHT, *supra* note 3, at xvii.

172. Note that, to the extent that the Contract Clause prohibits only retrospective laws, even such retrospective laws of general application would apply to an identifiable portion of the population. But, it seems to go without question that the power of eminent domain could nevertheless be used in a more targeted manner than general legislation.

impairment. As Luther Martin said, the Contract Clause leaves the people "without their governments having a power to give them a moment's indulgence" from the burden of debt.[173]

This result also comports with the Supreme Court's recent Contract Clause cases, which place emphasis in the analysis on the states' reserved police powers.[174] For instance, note the court's statement in *U.S. Trust Co. of New York v. New Jersey*, that "the scope of the State's reserved power depends on the nature of the contractual relationship with which the challenged law conflicts."[175] Thus, the court is using the Contract Clause prohibitions in measuring the state's police power. "Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power."[176] The court went on to reiterate that "private contracts are not subject to the unlimited modification under the police power," and that a state "'could not adopt as its policy the repudiation of debts.'"[177] Similarly, in *Allied Structural Steel*, the court noted that "[i]f the Contract Clause is to retain any meaning at all . . . it must be understood to impose some limits upon the power of the State to abridge existing contractual relationships, even in the exercise of its *otherwise* legitimate police power."[178]

Furthermore, the meaning of the police power does not, and should not, change from one analysis to the other; the scope of the states' sovereign power is the same in a Contract Clause case as it is in a Takings Clause case. This is because the sovereign police power is independent from, although limited by, the various provisions of the federal Constitution.[179] Thus, the limitations placed on that power by the Contract Clause exist just as fully in a Takings Clause case. And, therefore, if the scope of a state's power to use eminent domain is coterminous with the police power, then the limitations on the police power imposed by the Contract Clause must carry through to the state's use of eminent domain. In other words, if the Contract Clause prohibits a state from

173. MARTIN, *supra* note 50. Of course, Luther Martin overstates his point, since the government is free to enact prospective debtor relief laws. *See* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213 (1827).

174. *See* Energy Reserves Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400, 412 (1983) ("The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests.").

175. U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 21–22 (1977).

176. *Id.* at 21 (quoting Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 439 (1934)).

177. *Id.* at 22 (quoting *Blaisdel*, 290 U.S. at 439).

178. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 242 (1978) (emphasis added).

179. *See U.S. Trust Co. of N.Y.*, 431 U.S. at 21 ("[T]he Contract Clause limits otherwise legitimate exercises of state legislative authority . . . ."); Kelo v. City of New London, Conn., 545 U.S. 469, 497 (2005) (O'Connor, J., dissenting) ("The public use requirement [of the takings clause] . . . imposes a [basic] limitation, circumscribing the very scope of the eminent domain power . . . .").

passing a general law to achieve a particular purpose, then it equally prohibits the state from using its power of eminent domain to achieve that same purpose.

D. Application of the Principle to Debt-relief Takings

In order for the government to provide debt relief through a takings plan, it must first acquire the debt contracts from their current owners through the power of eminent domain. It could then modify the contracts to reduce the debt principal and subsequently sell the contracts back into the market.

Exercise of the eminent domain power to accomplish the necessary takings will implicate the Takings Clause of the Fifth Amendment,[180] which requires that the taking be for a public use and that the government pay the owner just compensation.[181] This analysis presumes that just compensation is paid the owners, and the constitutionality of the takings therefore turns on whether the takings satisfy the public use requirement of the Takings Clause. Although the court would normally defer to the government's judgment that the takings serve a public purpose,[182] the court must first determine that the government is otherwise acting within its police powers.[183] Here, Contract Clause would prevent the government from enacting legislation for the purpose or with the effect of repudiating contractual debt obligations.[184] As this discussion has shown, that prohibition represents a limit on the state's police power, which, through the public use requirement of the Takings Clause, also prevents the government from using eminent domain for the purpose or with the effect of reducing debt obligations. Thus, because the government's takings plan is not within the confines of its police powers, the public use requirement of the Takings Clause is not satisfied and the takings are therefore unconstitutional.

To be fair, this result is counterintuitive. For instance, if the government had taken the debt contracts as part of a plan to hold them for some legitimate public purpose,[185] such takings would not offend the Contract Clause under the

180. The Takings Clause of the Fifth Amendment is made applicable to the states through the Fourteenth Amendment. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 231 (1984).

181. U.S. CONST. amend. V. Note, as discussed *supra* note 179, that the public use requirement is an inherent condition on the state's exercise of its power of eminent domain, made explicit through the Fifth and Fourteenth Amendments.

182. *Kelo*, 545 U.S. at 480, 483. This analysis assumes that the government is acting rationally.

183. *See* Berman v. Parker, 348 U.S. 26, 32 (1954) ("*Subject to specific constitutional limitations*, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive.") (emphasis added). "Once the object is within the authority of Congress," the right to realize that object using the means of eminent domain is clear. *Id.* at 33.

184. U.S. CONST. art. I, § 10, cl. 1; *U.S. Trust Co. of N.Y.*, 431 U.S. at 22.

185. An interesting example would be the situation where the government takes mortgages in an effort to temporarily stay foreclosures, whereby the government would hold the mortgages temporarily without modifying them. The state could abstain from foreclosing of defaulting debtors for a period of time and then re-sell the mortgages back into the market. The valuation

principles laid out in this discussion. And, so long as not part of a unified plan, that result would likely be the same even if the contract debts were later modified by the government, as owners of the contracts. But the *Kelo* decision makes clear that the court looks to the entire plan in determining whether the government is acting within the public use requirement of the Takings Clause.[186] Thus, the fact that the government modifies the contracts after it takes ownership of them makes no difference if the initial takings were part of a plan that reduces the debtors' obligations, regardless of whether the plan's ultimate purpose is debtor relief or economic stimulus.[187]

Thus, the proposed takings are part of a plan that reduces debtors' principal obligations to their creditors. Such a plan is not within the police powers of the government by virtue of the Contract Clause and, therefore, the takings pursuant to that plan are not for public use as that term is used in the Takings Clause of the Fifth Amendment.

CONCLUSION

The concept of circumventing the limitations imposed by the Contract Clause of the Constitution, which has for over 200 years severely limited state-imposed debtor relief,[188] through the use of eminent domain is a novel idea with broad implications. If successful, virtually every debt subject to the jurisdiction of the states would be susceptible to being cut down to its fair market value. Executed in a time of recession when debts are experiencing significantly depressed values, the eminent domain tool could be wielded against creditors in a particularly potent manner. Not only could the states significantly reduce the debts of their citizens, but the threat of such action could be used to pressure creditors into other concessions as well. Whether there would be public support for such action considering the inevitable impact it would have on the credit market is another story.[189]

However, as this Article has attempted to show, the Constitution prevents states from achieving through the use of eminent domain what they are

issues associated with such a plan would be complicated, but legislation to that effect seems arguably permissible under *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934).

186. *Kelo*, 545 U.S. at 477–90.

187. States should be warned against attempting to take contracts under the pretext of furthering a legitimate public purpose, for the court will look through the pretext to the actual purpose of the course of conduct. *See id.* at 478.

188. *See* WRIGHT, *supra* note 3, at 19 (discussing *Champion* and *Dickenson v. Casey*).

189. *See* Lazo, *supra* note 23. As the case of San Bernardino County makes clear, public support might be a significant obstacle to these plans. However, the fact that other local governments are still considering the plan, combined with the fact that public support is dwindling in part because the economy is recovering, certainly leaves open the possibility that governments might be able to implement these types of plans in more supportive locales or in the heart of a future recession.

prohibited from achieving through general legislation. Indeed, if such were not the case, it would offend the reasonable and just notion that the law looks to the substance of a transaction over its form.[190] But alas, the court's Takings Clause jurisprudence provides a linkage to the Contract Clause that incorporates its prohibitions in the Takings Clause's public use requirement. With these two provisions thus interconnected, the states are prevented from using eminent domain to escape their constitutional limits.

But the implications of this linkage of the Takings Clause to Contract Clause are even broader. The principles and reasoning that led to the coupling of the Takings Clause and Contract Clause apply equally to other limitations in the Constitution. Thus, all of the constitutional limits on state power are properly incorporated into public use requirement of the Takings Clause, resulting in a simple test: if a constitutional provision limits the state's police power with respect to the enactment of general legislation, then that provision similarly limits the state's power with respect to the exercise of eminent domain.

As an example of this principle that is outside of the debt context, mass shootings have been in the spotlight in recent years, culminating most recently with the murder of twenty-six people, including twenty children, at Sandy Hook Elementary School in Newtown, Connecticut.[191] Since then, the debate over gun control has been heated, although there appears to be enough public support in certain parts of the country to pass significant gun control legislation, including bans on all or certain types of firearms.[192] However, such bans run into the roadblock of the Second Amendment to the federal Constitution, which secures to the people the right "to keep and bear Arms."[193] Although a law banning firearms would be unconstitutional,[194] a state might decide to circumvent the constitutional limitations of the Second Amendment by taking all of the firearms in its jurisdiction through eminent domain in the name of public safety.[195] Because the gun market would still exist outside that state's jurisdiction, it could re-sell the taken firearms back into the market for little or no ultimate cost to the taxpayer. If the principle set out in this Article did not apply, the state would thus be able to circumvent one of the most robust provisions in the Constitution. But, as discussed previously, the

190. For an example of this principle in the context of securities regulation, see *United Hous. Found. v. Forman*, 421 U.S. 837, 848 (1975) (stating that "form should be disregarded for substance and the emphasis should be on economic reality.").

191. *See* Peter Applebome, *Momentum and Uncertainty in Connecticut Gun Debate*, N.Y. TIMES, Feb. 15, 2013, at A24.

192. *See id.*

193. U.S. CONST. amend. II.

194. *See* Dist. of Columbia v. Heller, 554 U.S. 570, 636 (2008).

195. Public safety is generally considered to be within the scope of the state's police powers. *See* Berman v. Parker, 348 U.S. 26, 32 (1954).

principle set out in this Article does apply, and the prohibitions of the Second Amendment are properly incorporated into the public use requirement of the Takings Clause. Thus, the takings would be invalidated under the Takings Clause just the same as the debt takings.

The possibilities for using these types of takings plans are virtually limitless since the Court's decision in *Kelo*. However, this Article highlights why the states should not view eminent domain as a cure-all to their constitutional problems and should be wary of any proposals that claim to be able to circumvent fundamental constitutional limitations like those of the Contract Clause. Like most get-rich-quick schemes, they are usually too good to be true. In the case of the proposed mortgage takings plan, government leaders might have been justified in buying into the proposed plan since its unconstitutional nature was hidden behind constitutional text that facially permitted it.[196] And, to the extent that the Contract Clause prohibits only retroactive contract impairments,[197] a government with sufficient political muster is still able to enact legislation reserving to itself the power to relieve its debtor-citizens in future situations. The impacts of overbearing debt are far-reaching, but they are nothing new to this country; perhaps it is time that the states stop trying to take shortcuts and start planning ahead.

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196. MRP and participating government leaders are not the first to buy into the concept that eminent domain can be used to circumvent the Contract Clause. Even two high-ranking attorneys in the U.S. Department of Justice, staunch supporters of a strong Contract Clause limitation, claim as much to be true: "[i]f a legislature believes that changes are needed immediately, nothing . . . prevents the legislature from buying out contractual obligations under its eminent domain power so that the cost of voiding the obligations is borne by the community as a whole . . . ." Kmiec & McGinnis, *supra* note 99, at 554–55.

197. Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 221 (1827).

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