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# Purchasing the Right to Govern: Winstar and the Need to Reconceptualize the Law of Regulatory Agreements

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# Purchasing the Right to Govern: *Winstar* and the Need to Reconceptualize the Law of Regulatory Agreements

BY ALAN R. BURCH\*

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## INTRODUCTION

In *United States v. Winstar Corp.*,<sup>1</sup> the Supreme Court found the federal government liable under the Tucker Act for breach of contract. The Court found that the government had entered into contracts with the owners of savings and loans (“S&L”s) regarding the thrifts’ capital accounting when the thrift regulators approved mergers of the thrifts. Several years later, Congress enacted stricter capital rules as part of its broad reform of the S&L industry. The Court found that this new legislation breached the contracts represented by the regulatory approvals.<sup>2</sup> Understood simply as a contracts case, *Winstar* appears reasonable, even as it creates a new presumption that the government will pay damages when it changes regulatory policies reflected in agreements.

But *Winstar* is also about sovereign power, for both the approvals of the mergers and the subsequent capital rules represent examples of the government directly exercising regulatory authority. From this perspective, *Winstar* poses the question of how far the current majority, as represented by Congress, may go in altering or rescinding agreements made by previous majorities. It also raises the question of how easily a regulatory agency may bind the government as a whole, including Congress, to particular agreements and regulatory policies. The sovereign power perspective suggests a due process analysis, including administrative law principles due to involvement of a government agency. The sovereign power perspective suggests a far more permissive standard than that applied by the Court in *Winstar*.

The simple fact that the regulatory approval was reduced to a written document, consented to by both the thrifts and the regulators, however, creates the puzzling ambiguity that the contractual perspective and the sovereign power perspective each make sense in isolation, even though they suggest quite different legal standards. Ultimately, making sense of the law of regulatory agreements requires analyzing both perspectives.<sup>3</sup> This Article criticizes the *Winstar* Court for relying too simply on the contractual analysis and using that perspective to subtly manipulate its precedent and lay the groundwork for a conservative regulatory takings

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<sup>1</sup> *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

<sup>2</sup> *See id.* at 909-10.

<sup>3</sup> *See generally* *Jones v. United States*, 1 Ct. Cl. 383, 384 (1865) (“The two characters which the government possesses as a contractor and as sovereign cannot be thus fused; nor can the United States while sued in one character be made liable in damages for their acts done in the other.”).

agenda. By ignoring the implicit threshold issue of which perspective makes more sense, the Court leaves open the possibility that its new presumption of damages will apply to anything that could be styled as an agreement, be it administrative enforcement orders, regulatory approvals, or even run-of-the-mill licenses and permits. Much like the conservative regulatory takings agenda, this regime would force the current majority to buy its way out of outdated regulatory policies.

The law of regulatory agreements, as discussed herein, consists of the four special contract defenses, available only to the government, raised in the *Winstar* case.<sup>4</sup> For each of these defenses, Part I of this Article reviews the case law establishing the defense, critiques the defense as it existed prior to *Winstar*, and then evaluates the Court's analysis of the defense.<sup>5</sup> The first of these special defenses—the unmistakability doctrine—is essentially a rule of strict construction that presumes that the government, in making an agreement regarding its regulation of a private party, has not promised to restrain future use of its sovereign power, unless the intent to do so appears unmistakably clearly in the agreement. The unmistakability doctrine seeks to protect the current majority's ability to revise and change outdated policies, but still allows a way for the government to bind future governments. Given the power of the unmistakability doctrine to excuse the government from contract liability, there is an obvious but largely unresolved question of how to properly limit the circumstances where the government may raise the doctrine.

The unmistakability doctrine dominates the Court's four opinions in *Winstar*. Part I of this Article provides an extensive review of the precedent establishing the unmistakability doctrine, in order to better illuminate the Court's manipulation of the precedent. The Court establishes a new rule that is essentially the opposite presumption: that the government *has* promised to pay damages if any future use of its sovereign power results in a different regulatory policy than the one set forth in the prior agreement. This presumption does not prevent outright the subsequent government from enacting new legislation, but it does force the government to pay damages to all parties who can build a case of reliance on the old rule. While it is possible that parties to regulatory agreements could bargain around either the traditional unmistakability doctrine or the new presumption from *Winstar* (if both parties had full information about the rule, of course), the *Winstar* rule is a sea change that leaves most existing regulatory agreements potentially vulnerable to damages claims if the

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<sup>4</sup> See *Winstar*, 518 U.S. at 860.

<sup>5</sup> See *infra* Part I.

policies reflected therein are changed in the future. The *Winstar* rule, therefore, puts a steep price on new policies, especially those replacing older and broader policies affecting more people and companies. Rather than balancing the needs of the current majority to govern with the legitimate reliance interests of individuals, *Winstar* sacrifices the majority's freedom to change policies. In so doing, it hands a windfall to individuals, who should have included the possibility of new policies in calculating their reliance interests in the old rule.

Historically, it is true that the Court's efforts to achieve this balance have been hampered by its analytical habit of relying solely on the contractual perspective. This has led the Court, when ruling for the government, to create exceptions to contract law for the government (i.e., the four special defenses), instead of constructing a more logical framework that also incorporates the sovereign power perspective. This probably explains the inconsistency in the Court's application of the unmistakability doctrine. The failure to incorporate both perspectives has also left the Court without any articulated understanding of when the unmistakability doctrine should apply, just as it has never articulated any principle for deciding which perspective makes more sense in a given case. *Winstar* lurches through this hole to provide a new rule for when the unmistakability doctrine should apply: only when the plaintiff's claim necessitates a remedy equivalent to an injunction blocking the new law. Such cases will necessarily be extremely rare, given how much control plaintiffs have over their own damages theories. This new rule, therefore, serves to eviscerate the unmistakability doctrine. Instead of taking the doctrine seriously, the *Winstar* plurality essentially ignores the sovereign power implications of its rule by disingenuously asserting that damages remedies do not block the use of sovereign power. *Winstar* thus gives individuals far more protection than they have ever had over any reliance interests they might have in regulatory policies. This comes at the direct expense of the majority who might wish to change those policies because, for example, the policies did not work.

Like the unmistakability doctrine, the other three special contract defenses arose from the same need to balance the current majority's power to govern effectively and individuals' reliance interests.<sup>6</sup> One of the unfortunate aspects of the law of regulatory agreements is that the Court has never seemed to recognize how these defenses overlap or contradict one another. *Winstar* too makes no attempt at unifying the defenses. Indeed, upon closer examination, it appears that the plurality's reasoning

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<sup>6</sup> See *Winstar*, 518 U.S. at 874.

on these other defenses is largely driven by the need to avoid creating logical weaknesses in the Court's rationale justifying the new rule for the unmistakability doctrine.

The strongest example of this appears in the plurality's reasoning on the sovereign acts doctrine, another of the four special contract defenses, which provides "that the United States when sued as a contractor cannot be held liable for an obstruction to the performance of the particular contract resulting from its public and general acts as a sovereign."<sup>7</sup> Courts have traditionally focused on the "public and general" aspect of the subsequent statute or administrative order, and *Winstar* is no exception.<sup>8</sup> Thus, when subsequent legislation has a broad effect on many persons beyond merely the class of persons who contracted with the government, the government is not liable to that class for breach of contract. A straightforward application of the sovereign acts doctrine should have resulted in no defense for the government in *Winstar*, because the 1989 reform legislation specifically targeted for repeal the capital treatments accorded thrifts, such as the plaintiffs. Despite the fact that the Court could have simply applied the sovereign acts doctrine as is and reached the same result, the plurality goes well out of its way to reformulate the reasoning behind the sovereign acts doctrine, even though it re-establishes essentially the same public and general standard as existed before. The reformulated reasoning, however, avoids the sovereign acts doctrine's distinction between the government's role as a contractor from that of a sovereign.

Indeed, it appears that the reason for this tortured analysis is to avoid endorsing the distinction between the sovereign and contracting (or private) roles of the government. Endorsing this distinction would suggest a logical and practical way to govern when the first defense—the unmistakability doctrine—should apply. The unmistakability doctrine, after all, has always aimed to protect the government's sovereign powers, which are implicated when the government acts in its sovereign role and not when the government acts as a typical, private contracting party, for example when it hires employees.<sup>9</sup> It makes sense, therefore, to limit the unmistakability doctrine to cases where the government acted in a sovereign capacity and not in a private contractual capacity. This logical limitation on the use of the unmistakability doctrine would, however, avoid the need for the Court to limit the unmistakability doctrine to an impossibly narrow set of circumstances. Moreover, the plurality's reformulation of the sovereign acts

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<sup>7</sup> *Horowitz v. United States*, 267 U.S. 458, 461 (1925).

<sup>8</sup> See *Winstar*, 518 U.S. at 891-910.

<sup>9</sup> See *id.* at 880.

doctrine also helps it defeat another potential problem with its reasoning on the unmistakability doctrine. As explained below,<sup>10</sup> the plurality uses a purely contractual perspective to turn on its head the widely accepted reasoning that a private party's reliance interests in government policy are necessarily limited in highly regulated industries.

The plurality dismisses the other two special contract defenses with the same reasoning it used to sidestep the unmistakability doctrine; these defenses no longer apply when plaintiffs seek a damages remedy.<sup>11</sup> One of these defenses, the reserved powers doctrine, should have been abandoned long ago. With luck, *Winstar* will consign it to the dust bin. The other defense, however—the express delegation doctrine—should command far greater respect than it has traditionally been accorded. It can help clarify the limits of an administrative agency's power to bind the government as a whole to policies selected by the agency, or even to bind the government to paying damages for changes in these policies.

Under an updated reading of the express delegation doctrine, the regulatory approvals in *Winstar* should have been interpreted as binding the *banking agencies* to honor the promised capital accounting treatments as long as the agencies continued to have statutory authority to honor them. The express delegation doctrine should require something more, however, for an agency to impose liability on the federal treasury for subsequent legislation from Congress that reverses the agency's regulatory policy. This interpretation of the express delegation doctrine suggests that the Administrative Procedures Act, instead of contractual theory, should provide the basis for enforcing regulatory agreements. This would allow for enforcement of the agreements against the government without having to resort to a contractual analysis. This reading of the express delegation doctrine would also better police the separation of functions between the legislative and executive branches. Furthermore, it would go further towards meeting goals of both allowing the current majority the freedom to revise policies selected by regulators and protecting the reliance interests of individuals who extract promises from regulators. As with the other defenses, however, *Winstar* adopts a purely contractual perspective that fails to balance the need for the current majority to govern effectively and the need to protect individuals' reliance interests.

*Winstar* throws nearby areas of law into confusion. Claims of reliance on regulatory agreements have historically been litigated under three different clauses of the Constitution: the Contracts Clause, the Due Process

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<sup>10</sup> See *infra* Part I.E.

<sup>11</sup> See, e.g., *Winstar*, 518 U.S. at 891.



Clause, and the Takings Clause. A deeper and broader analysis of relevant case law illustrates clearly that the presence of sovereign power in regulatory agreements has always made a controlling difference in the Court's holdings. At the same time, the damages/injunction distinction urged by the plurality has never made such a difference. But even more disturbing than *Winstar's* disregard for precedent is the fact that the damages-friendly rule in *Winstar* creates tremendous pressure for plaintiffs to repackage heretofore losing takings claims as *Winstar* claims. Doctrinally, this encourages debate about which category a given claim belongs in, rather than on what standard should control the outcome. This debate about the category, or definition, of a claim inevitably confuses the underlying substantive issues and leads to more arbitrary and inconsistent applications of whatever rules are developed. Indeed, legal standards ought to be evaluated explicitly in terms of whether they create pressure to stretch the definitions of neighboring or analogous legal standards. *Winstar* seriously fails on this measure because it pretends to be a case about contracts, when a more intellectually honest—and doctrinally useful—analysis would acknowledge the decision's impact on the neighboring jurisprudences of due process, takings, and the Contracts Clause.

Part II of this Article synthesizes the concerns raised in Part I and proposes an alternative legal framework for the law of regulatory agreements.<sup>12</sup> The framework seeks to reconcile the sovereign power and contractual perspectives and improve upon the balance between the needs of the majority and individual reliance interests. The framework aims to set clear standards for when Congress and agencies retain the power to change regulatory policies and when, instead, individuals can rely on continuation of policies. The key to the proposal is distinguishing between when the initial governmental agreement concerns the use of its sovereign power and when it instead represents the government acting as a private, commercial entity. Certain defenses, such as the unmistakability doctrine and the express delegation doctrine, make sense only when the agreement at issue involves the government acting in its sovereign role. The sovereign acts doctrine, on the other hand, should apply to the government when acting in its private, or corporate, capacity in making the original agreement. The lynchpin to the proposal is the test for distinguishing between the sovereign and private roles of the government. Though periodically criticized as unworkable, this distinction can be reduced to a simple test that is consistent with nearly all relevant Supreme Court decisions.

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<sup>12</sup> See *infra* Part II.

The proposed framework is superior to the regime of *Winstar* for several reasons. Most importantly, it does not saddle the current legislative majority, acting through Congress, with the crushing expense of buying off the consent of every individual who came to rely on the policies of the past. At the same time, the framework provides at least as much (and more certain) protection for individuals' reasonable reliance interests than the law pre-*Winstar*. The proposed framework also tackles other issues left unaddressed by courts and commentators alike. It clarifies the relationships between the various special contract defenses, and in so doing clarifies the reasoning behind each defense. For example, it suggests elimination of the reserved powers doctrine, which provides that certain governmental powers may never be bargained away, because it logically contradicts the unmistakability doctrine, which provides that any governmental power may be bargained away if done so with unmistakably clear language. Finally, the proposed framework minimizes the definitional pressure between claims based on breach of regulatory agreements and those based on takings, economic due process, or the Contracts Clause. This broader synthetic approach provides another perspective on just how out of step the decision in *Winstar* really is. Apparently designed by clever plaintiffs' lawyers, the *Winstar* rule single-mindedly functions to create a backdoor for regulatory takings claims, without regard to the damage done to surrounding jurisprudences, let alone to the power of legitimate majorities to govern effectively.

Few critics have explored the implications of *Winstar* or recognized the two perspectives on regulatory agreements. The most probing analysis of *Winstar* appears in two articles by Professor Schwartz, published just before and after the Court decided *Winstar*.<sup>13</sup> Schwartz frames his analysis around two divergent themes he identifies in the law of government agreements and contracts: "congruence" refers to the rules that treat the government the same as any other private contracting party, while "exceptionalism" refers to contract rules that apply only to the government.<sup>14</sup> This Article adopts these terms, albeit with the reservation

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<sup>13</sup> See Joshua I. Schwartz, *Liability for Sovereign Acts: Congruence and Exceptionalism in Government Contracts Law*, 64 GEO. WASH. L. REV. 633 (1996) [hereinafter Schwartz, *Liability for Sovereign Acts*]; Joshua I. Schwartz, *Assembling Winstar: Triumph of the Ideal of Congruence in Government Contracts Law?*, 26 PUB. CONT. L.J. 481 (1997) [hereinafter Schwartz, *Winstar: Triumph of Congruence*].

<sup>14</sup> See Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 637-38; Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 489-90.

that this dichotomy still fits too well within the contractual perspective and so tends to ignore the deeper ambiguity within the law of regulatory agreements.

This Article will subdivide the terms "contracts" and "agreements" into three separate categories that reflect the presence or absence of the government's regulatory power. "Contracts" will refer to contracts between private parties. "Government contracts" will refer to contracts between a private party and the government acting in a non-regulatory capacity, for example, typical procurement and government employment contracts. Finally, "regulatory agreements" refer to agreements between a regulated entity and the part of the government with direct regulatory authority over the entity, where the agreement concerns the government's regulation of the entity.

The law of regulatory agreements will become increasingly important as the government looks more frequently to more cooperative methods of regulation. *Winstar* itself will likely add some \$10 to \$30 billion to the cost of the S&L cleanup.<sup>15</sup> This alone makes the decision worthy of close scrutiny. More importantly, by reducing to the vanishing point any analytical difference between regulatory agreements and contracts, *Winstar's* reasoning could just as easily be applied to any sort of governmental grant, license, or permit. Consider also the government's efforts to reach an agreement with the tobacco industry on liability for smoking-related injuries and the government's role in regulating the industry, or the

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<sup>15</sup> For estimates of the cost of the *Winstar* decision, see Richard B. Schmitt, *Rogues' Revenge: Why an S&L Crook Believes Uncle Sam Owes Him Millions*, WALL ST. J., Apr. 8, 1999, at A1 (estimating \$30 billion); see, e.g., Stephen Labator, *The Debacle that Buried Washington*, N.Y. TIMES, Nov. 22, 1998, at 1 (citing estimates from \$4 to \$50 billion); Michael Grunwald, *Lawsuit Surge May Cost U.S. Billions*, WASH. POST, Aug. 10, 1998, at A1 [hereinafter Grunwald, *Lawsuit Surge*] (estimating \$32 billion for *Winstar* claims of S&L owners and citing an estimate of \$31 to \$53 billion for similar lawsuit arising out of the government's nuclear waste policies). Thirty billion dollars works out to over \$1000 per American citizen. Much depends on the theory of damages that the courts eventually settle upon. Compare Michael Grunwald, *Thrift Wins \$908 Million from U.S. in Dispute from S&L Crisis*, WASH. POST, Apr. 10, 1999, at A6 (reporting that the judge rejected one thrift's lost profits claim for \$2 billion and adopted instead a restitution theory) with *Cal Fed Vows Goodwill Appeal—Judge Gave it Just \$23 Million*, AM. BANKER, Apr. 20, 1999, at 2 (reporting that the court rejected the restitution theory and awarded only the costs of securing replacement capital). Thrift owners have filed 125 *Winstar* cases. See Grunwald, *Lawsuit Surge*, *supra*.

Justice Department's anti-trust litigation against Microsoft. If these disputes result in settlements, will contractual analysis of their enforcement best serve the ends of justice and effective government? Should the government pay damages if activities allowed in these settlement agreements are later prohibited? If the government litigated these matters to their conclusion, and a generation later changed the laws to prohibit activities carved out of the final orders, should compensation be owing? The law of regulatory agreements deserves far greater attention than it has received so far, and *Winstar* is not the answer.

## I. *UNITED STATES V. WINSTAR CORP.*

### A. *Background*

#### 1. *The Savings and Loan Crisis*

The story of the thrift crisis of the 1980s begins in the late 1970s when the economic landscape unexpectedly began to experience the new phenomenon of high interest rates and high inflation. For many years, the bread-and-butter of many, if not most, thrifts had been long-term, fixed-rate home mortgages.<sup>16</sup> Unfortunately, the higher interest rates forced thrifts to raise the interest paid on their deposits. This quickly undermined the thrifts' profit margins since they could not raise the interest on their fixed-rate loans, nor could they hope to sell many of these loans and make new loans at market rates, since the secondary market for loans was poorly developed and these assets were less desirable given the high interest rates available elsewhere. Responding to early warning signs, Congress and the regulators permitted thrifts in the early 1980s to move into previously impermissible forms of lending, notably commercial real estate, which offered higher profits and greater risks.<sup>17</sup>

Regulators also loosened the capital<sup>18</sup> standards applicable to thrifts in order to give the growing number of weaker institutions extra breathing

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<sup>16</sup> See *Winstar*, 518 U.S. at 845.

<sup>17</sup> See National Commission on Financial Institution, Reform, Recovery and Enforcement, *Origins and Causes of the S&L Debacle: A Blueprint for Reform* (1993) (commissioned by FIRREA) [hereinafter National Commission].

<sup>18</sup> "Capital" can be defined two ways. First, as the total amount of equity paid into the institution by shareholders plus retained earnings less certain deductions required under bank accounting rules. This amount should always equal the amount under the second definition of capital, which is essentially the net worth of the in-

room, thereby reducing the number of thrifts that would need to be liquidated and eventually bailed out by the FSLIC. Nevertheless, the number of failing thrifts quickly threatened to exhaust the funds available in FSLIC to pay depositors as required by law.<sup>19</sup> The thrift regulators appealed to Congress for more insurance funds, but these appeals were largely ignored.<sup>20</sup> The thrift regulators soon hit on a strategy of supervisory mergers whereby healthy institutions would take over weak or failing ones; with a bit of luck, the combined institutions would be strong enough to grow out of the problems of their weaker predecessors.

In addition to making educated guesses about which institutions could be appropriately merged, regulators used two unusual provisions in approving these merger transactions to increase the chances of success. The first was supervisory goodwill. Supervisory goodwill represented a sort of phantom asset whose initial value was calculated from the difference between what the acquiring institution paid for the weaker target and the

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stitution. From the thrift's perspective, loans are assets and deposits are liabilities. So the net worth is the amount left over on the asset side of the ledger after all the depositors and other creditors have been paid. This is the more useful definition of capital in the context of bank failures. Bank and thrift regulations have traditionally required financial institutions to maintain capital above a certain percentage of total assets. This capital acts as a buffer protecting the government's deposit insurance fund against loss. The minimum needs to be well above zero because in a typical bank failure, there is an inevitable lag between identification of critical weakness and actual closing of the bank; during this time, the value of the assets often decline further. Thus, the higher the minimum level of required capital, the earlier a failing institution can be identified and the lower the probable liability of the government's insurance fund. Of course, higher capital requirements tie up bank assets and thus reduce the bank's profit potential.

<sup>19</sup> This is how the taxpayers got involved. The funds in FSLIC came from fees paid by banks and thrifts but these funds ran out. By 1989, the treasury was on the hook for over \$50 billion, and by 1995 the cost reached an estimated \$140 billion. *See generally Winstar*, 518 U.S. at 844-48.

<sup>20</sup> The question of whether the banking agencies prudently responded to the S&L crisis ultimately raises the questions of whether the regulators did enough to explain the problem to Congress. One could argue that the pleas from FSLIC and the FHLBB were muted by their prior advocacy of loosening capital standards and broadening thrift powers. On the other hand, Congress probably discounted the alarms the regulators raised and listened too much to the thrift lobby. For a balanced analysis, *see generally* National Commission, *supra* note 17, at 1 (citing as major precipitating factors the rise interest rates, the new asset powers granted to thrifts by Congress, and relaxation of regulatory standards).

target's market value.<sup>21</sup> Supervisory goodwill had no value at all other than the fact that the regulators permitted the merged institution to count it towards minimum capital requirements. This supervisory goodwill would be amortized over a long period of time, often thirty years, but this amortization differed in important ways from the generally accepted accounting principles. One result of these differences was that the merged institution enjoyed artificially inflated profits in the first few years after the merger.<sup>22</sup> Supervisory goodwill did not fix any of the weaknesses in the loan portfolios. It merely let the thrifts live with them. Keeping the thrifts open longer left them free to dig deeper holes for themselves and, ultimately, for the FSLIC. Supervisory goodwill was used purely to entice the stronger thrifts to buy weaker ones.

The second unusual provision in these merger approvals were net worth maintenance agreements ("NWMA's") sometimes called capital maintenance agreements. The NWMA's required new owners, whether individuals or holding companies, to invest additional money in the combined entity after the merger if regulators subsequently determined that the combined thrift fell below minimum capital requirements. Regulators used the NWMA's to compensate for risk created by the supervisory goodwill. Supervisory goodwill gave the new owners the time to rehabilitate their institutions' weaker portfolios, but the personal liability would both encourage the owners to grow in cautious ways and provide an additional source of funds to back up FSLIC. The FHLBB sought to include NWMA's in virtually every supervisory merger approval that involved supervisory goodwill. One of the unfortunate tendencies in analysis of the thrift crisis has been viewing the NWMA's as separate from the supervisory goodwill provisions. Viewed in isolation, both appear far less rational than when they are viewed in combination, which is how they nearly always were used.<sup>23</sup>

Nevertheless, these policies did not work very well. The real estate crash in the 1980s hit harder and lasted longer than any in living memory. Even though many thrifts had moved away from fixed-rate mortgages and into variable-rate mortgages, the value of these portfolios plummeted precipitously but, thanks in part to supervisory goodwill, often took years to hit bottom. When the depth of the real estate problems finally became

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<sup>21</sup> See *Winstar*, 518 U.S. at 849 n.4.

<sup>22</sup> See *id.* at 848-56.

<sup>23</sup> See, e.g., Howell E. Jackson, *The Expanding Obligations of Financial Holding Companies*, 107 HARV. L. REV. 509, 520 (1994) (noting that NWMA's were almost always required in approvals granting supervisory goodwill).

apparent, supervisory goodwill came to look more like a desperate gamble of double-or-nothing. To make matter worse, the NWMA's provided no help, because the courts began to reject the agencies' theories for enforcing them.<sup>24</sup>

Congress responded in 1989 by enacting the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA").<sup>25</sup> FIRREA abolished the FHLBB and FSLIC and replaced them with the Office of Thrift Supervision ("OTS") and the Savings Association Insurance Fund ("SAIF") administered by the Federal Deposit Insurance Corporation ("FDIC").<sup>26</sup> Criticizing the "capital gimmicks"<sup>27</sup> used by the FHLBB, Congress included a provision phasing out all supervisory goodwill by 1995.<sup>28</sup> Most in Congress appreciated that FIRREA would revoke the promises made by the FHLBB regarding supervisory goodwill. Typical was the reaction of Rep. Ackerman: "In its present form, [FIRREA] would abrogate written agreements made by the U.S. government to thrifts that acquired failing institutions by changing the rules in the middle of the game."<sup>29</sup> Congress probably knew that FIRREA would unleash a second flood of thrift failures by withdrawing supervisory goodwill,<sup>30</sup> but it wisely realized that, as bad as this would be, without strong action the S&L crisis could still have become far worse. FIRREA broke the industry's and

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<sup>24</sup> See, e.g., *United Liberty Life Ins. v. Ryan*, 985 F.2d 1320, 1332-33 (6th Cir. 1993) (Contie, J., concurring) (reaching merits and finding NWMA not to be a contract); *FSLIC v. Capozzi*, 855 F.2d 1319 (8th Cir. 1988), *vacated on other grounds*, 490 U.S. 1062 (1989), *on remand*, 877 F.2d 727; *RTC v. Tetco, Inc.*, 758 F. Supp. 1159 (W.D. Tex. 1990), *vacated*, 1992 WL 437650 (5th Cir. Apr. 22, 1992); *FSLIC v. Savers*, U.S. Dist. 1989 WL 248120 (E.D. Ark. Dec. 14, 1989); *In re Conner Corp.*, No. 87-01697-MO4, 1990 WL 124052 (Bankr. E.D.N.C. June 20, 1990), *aff'd*, 127 B.R. 775 (E.D.N.C. 1991); *but cf. In re Deltacorp, Inc.*, 111 B.R. 419 (Bankr. S.D.N.Y. 1990); *In re Securities Groups*, 116 B.R. 839 (Bankr. M.D. Fla. 1990).

<sup>25</sup> Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183.

<sup>26</sup> See *Winstar*, 518 U.S. at 856.

<sup>27</sup> H. REP. at 310.

<sup>28</sup> See *Winstar*, 518 U.S. at 857 (citing 12 U.S.C. § 1464(t)(3)(A) (1933)).

<sup>29</sup> *Id.* at 900-01 (quoting 135 Cong. Rec. 12145 (June 15, 1989)). See also *id.* at 901-02.

<sup>30</sup> See, e.g., *id.* at 858 (quoting William K. Black, *Ending Our Forebearers' Forbearances: FIRREA and Supervisory Goodwill*, 2 STAN. L. & POL.'Y REV. 102, 107 (1990) for estimate that over 500 thrifts failed to meet FIRREA's new capital requirements).

FHLBB's double-or-nothing mindset that it could grow out of its problems. The withdrawal of supervisory goodwill, along with enhanced regulatory enforcement powers, provided considerable assurance that the financial institutions open in this country were all in actual fact reasonably healthy.

The post-FIRREA wave of failures required another bailout by the taxpayer, but on balance the legislation was a necessary and responsible response. Several thrift owners whose financial institutions were closed after having their supervisory goodwill taken away then sued the government for breach of contract, claiming the regulatory approvals created a contractual obligation for the government to recognize supervisory goodwill. Since these alleged contracts involved regulatory policies, as opposed to commercial transactions, one could also frame the question raised by *Winstar* as whether the costs of FIRREA's second bailout should include an estimated \$10 to \$30 billion of lost profits to those owners whose thrifts would still be open but for the annulment of supervisory goodwill.<sup>31</sup>

## 2. Arguments Raised in *Winstar*

Three thrifts brought separate actions against the United States in the Court of Federal Claims<sup>32</sup> seeking damages for breach of contract under the Tucker Act.<sup>33</sup> Each thrift prevailed at the trial court on summary judgment on the issue of contract liability and the cases were consolidated on appeal.<sup>34</sup> The court of appeals initially reversed, but later vacated this decision and affirmed *en banc*.<sup>35</sup> The initial panel based its decision on the unmistakability doctrine, which provides that the government is not liable on a contract if the contract terms involve a promise by the government to exercise or refrain from exercising a sovereign power. The unmistakability doctrine requires that such a promise be "unmistakably clear" in the contract to hold the government liable.<sup>36</sup>

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<sup>31</sup> See *supra* note 15.

<sup>32</sup> See *Winstar*, 518 U.S. at 858.

<sup>33</sup> 28 U.S.C. § 1491.

<sup>34</sup> See *Statesman Sav. Holding Corp. v. United States*, 26 Cl. Ct. 904 (1992) (finding the government liable to both The Statesman Group, Inc. and Glendale Federal Bank, FSB); *Winstar Corp. v. United States*, 25 Cl. Ct. 541 (1992) (*Winstar II*); *Winstar Corp. v. United States*, 21 Cl. Ct. 112 (1990) (*Winstar I*).

<sup>35</sup> See *Winstar Corp. v. United States*, 994 F.2d 797 (Fed. Cir. 1993), *vacated en banc*, 64 F.3d 1531 (Fed. Cir. 1995).

<sup>36</sup> See, e.g., *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52 (1986) ("POSSE").



The full court of appeals rejected the initial panel's conclusion and found the government's promise was unmistakably clear. In addition, the court went on to find that the unmistakability doctrine should not apply when the plaintiff seeks only monetary damages, because damages would not prevent the exercise of sovereign power contrary to the contract. Instead, it only creates monetary liability for the treasury.<sup>37</sup> The full court also rejected the government's defense based on the sovereign acts doctrine, which shields the government from contract liability when the governmental act causing breach was public and general and not targeted at the individual contract.<sup>38</sup>

The Supreme Court granted certiorari and affirmed, with Justice Souter writing the plurality opinion joined by Justices Stevens, Breyer, and in large part, O'Connor. Justice Breyer wrote a separate opinion in addition to signing onto Souter's. Justice Scalia concurred, joined by Justices Kennedy and Thomas. Chief Justice Rehnquist dissented, joined by Justice Ginsberg in large part. The 4-3-2 split in the opinions has caused some uncertainty as to what *Winstar* stands for, and this is discussed further below. Justice Souter organized his opinion around the four defenses raised by the government in its brief urging reversal of the court of appeals' decision: unmistakability, sovereign acts, and two other defenses referred to as the reserved powers doctrine and the express delegation doctrine.<sup>39</sup> The government's brief combines these last two defenses and so presents itself as making three main arguments. As argued below, this weakened the government's argument by obscuring the force of the express delegation doctrine which arguably should have been the strongest of the four defenses.

Souter sets the tone for his analysis early by avoiding discussion of the "anterior question of whether they were contracts at all."<sup>40</sup> Souter notes that the parties briefed and argued the question, but sets it aside as not being part of the writ of certiorari.<sup>41</sup> As argued below, the question of whether the regulatory agreements constitute contracts is better seen as inseparable from the threshold issue of whether to apply a contractual analysis or a due process analysis designed for scrutinizing the fairness of government's exercise of its sovereign power.

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<sup>37</sup> See *Winstar Corp.*, 64 F.3d at 1540-43 (holding that the government's promises were unmistakably clear); *id.* at 1545-48 (ruling the unmistakability doctrine should not apply).

<sup>38</sup> See *id.* at 1548-51.

<sup>39</sup> See *United States v. Winstar Corp.*, 518 U.S. 839, 860 (1996).

<sup>40</sup> *Id.*

<sup>41</sup> See *id.*

The four special contract defenses are presented below in an order designed to minimize confusion. The reserved powers doctrine can stand alone logically and so comes first, though the Court did not address it first. Then comes the unmistakability doctrine, which dominates the debate among the Court's opinions. The express delegation doctrine is presented next because it arose out of the unmistakability doctrine and its original version is better understood as an outgrowth of the unmistakability doctrine. The sovereign acts doctrine is presented last because the tortured and unnecessary reasoning that the plurality applies to it is best understood when one has thoroughly in mind the need to find a limiting principle for application of the unmistakability doctrine. The plurality's reasoning on the sovereign acts doctrine is best understood as working hard to avoid a more reasonable limiting principle than the one it creates.

### B. *Reserved Powers Doctrine*

This section argues that the reserved powers doctrine was never particularly well defined nor widely followed and has outlived any usefulness it may have had.<sup>42</sup> The reserved powers doctrine traces back to *Stone v. Mississippi*.<sup>43</sup> In 1867, the provisional government of the State of Mississippi granted a corporate charter to the plaintiff permitting him to run a lottery for profit. In 1870, the state ratified a new constitution as part of Reconstruction and the new constitution banned lotteries such as plaintiff's. The legislature enacted a ban, the state fined Mr. Stone for running his lottery, and Stone sued.<sup>44</sup> The Court upheld the new ban, reasoning, essentially for the first time, that states can neither waive nor bargain away their police powers.<sup>45</sup> Police powers were by then defined to

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<sup>42</sup> Because both the doctrine and this section commenting on it can easily be removed from the rest of the study of *Winstar* and the law of regulatory agreements, readers not interested in this doctrine specifically could skip this section.

<sup>43</sup> *Stone v. Mississippi*, 101 U.S. 814 (1880). Cf. Stewart E. Sterk, *The Continuity of Legislatures: Of Contracts and the Contracts Clause*, 88 COLUM. L. REV. 647, 675-76 (1988) (identifying *Boyd v. Alabama*, 94 U.S. 645, 650 (1876), as a precursor to a related government contract defense); Janice C. Griffith, *Local Government Contracts: Escaping from the Governmental/Proprietary Maze*, 75 IOWA L. REV. 277, 295 (1990) (referring to *Boyd* as the beginning of various "inalienable powers doctrines").

<sup>44</sup> See *Stone*, 101 U.S. at 815-16.

<sup>45</sup> For an interesting take on the development of the police power category, see Samuel R. Olken, *Charles Evan Hughes and the Blaisdell Decision: A Historical*

mean state and local governmental control over the public's health, safety, and morality. So as not to lose the connection to public welfare, the Court labeled lotteries a "pestilence,"<sup>46</sup> more harmful than other forms of gambling. Therefore, regulation of lotteries fit squarely within the state's police powers and the state always reserved the power to regulate lotteries.<sup>47</sup>

Theoretical difficulties in such a rule appeared immediately when the Court attempted to distinguish *Dartmouth College v. Woodward*,<sup>48</sup> which held that the Contracts Clause prevented New Hampshire from altering Dartmouth College's charter, granted by the king of England before the Revolution.<sup>49</sup> The Court in *Stone* argued that taxation is not a police power because "government was not organized for the purpose of taxation, but taxation may be necessary for the purposes of government."<sup>50</sup> This distinction between police power and taxation breaks down where taxation serves policy goals by discouraging certain activity. The Court then argued that the lottery charter was not a protected contract because it did not involve property rights: instead the charter involved "governmental rights"<sup>51</sup> because it was so linked to the police power.<sup>52</sup> Of course, the charter involved both property and governmental rights, just like taxation.

The distinction between police and other governmental powers inevitably grew fuzzier over time. For example, the Court in *Walla Walla v. Walla Walla Water Co.*<sup>53</sup> enforced as a contract a city's grant of a twenty-five year franchise to provide water to the city. It rejected the reserved powers argument of the city because water supply regulation was

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*Study of Contract Clause Jurisprudence*, 72 OR. L. REV. 513, 542-52 (1993) (arguing that the notion of police powers receiving special treatment was raised in early 19th century cases but did not prevail until after the Civil War). *See, e.g.*, *Jefferson Branch Bank v. Skelly*, 66 U.S. (1 Black) 436 (1862) (rejecting the reserved powers argument and finding a violation of the Contracts Clause in new tax on a bank contrary to the no-tax provision in the bank's charter).

<sup>46</sup> *Stone*, 101 U.S. at 818.

<sup>47</sup> *See id.*

<sup>48</sup> *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

<sup>49</sup> *See id.* at 519.

<sup>50</sup> *Stone*, 101 U.S. at 820.

<sup>51</sup> *Id.*

<sup>52</sup> *See id.* at 820-21. The Court added the argument that the property interest in the lottery charter should have been discounted by the risk that the government would later ban lotteries; this is clearly dicta in light of the breadth of the rule from *Stone*.

<sup>53</sup> *Walla Walla v. Walla Walla Water Co.*, 172 U.S. 1, 15-17 (1898).

not part of “peace, good order, health, or morals of its inhabitants.”<sup>54</sup> In another case, regulation of street lighting was not seen as sufficiently related to the public safety to allow application of the doctrine.<sup>55</sup> The Court in *Veix v. Sixth Ward Building & Loan Ass’n*<sup>56</sup> found no violation of the Contracts Clause in a New Jersey statute that put significant restrictions on the ability of a shareholder of a state-chartered thrift to redeem his stock. Citing *Stone*, the Court reasoned that the police power “is not limited to health, morals and safety. It extends to economic needs as well.”<sup>57</sup>

The Court used this same formalistic definition of police power in takings cases, beginning most notably with *Mugler v. Kansas*,<sup>58</sup> where the Court took the somewhat extreme position that the state owed no compensation for taking private property if the taking occurred pursuant to a valid police power. The Court eventually relaxed this rule in takings law, most notably in *Pennsylvania Coal Co. v. Mahon*,<sup>59</sup> but never clearly defined when the government would have to pay compensation for regulatory takings in a legitimate exercise of its police powers. The Contracts Clause cases addressing the definition of police powers did no better, and indeed

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<sup>54</sup> *Id.* at 15-17.

<sup>55</sup> See *Los Angeles v. Los Angeles Gas & Elec. Co.*, 251 U.S. 32, 38 (1919) (holding that the city could not remove private street lighting and install its own without compensating the owner of the private lighting, where the city granted a franchise to provide the lighting).

<sup>56</sup> *Veix v. Sixth Ward Bldg. & Loan Ass’n*, 310 U.S. 32 (1939).

<sup>57</sup> *Id.* at 38-39.

<sup>58</sup> *Mugler v. Kansas*, 123 U.S. 623 (1887).

<sup>59</sup> *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922) (“[I]f a regulation goes too far, it will be recognized as a taking.”). See also William B. Stoebuck, *Police Power, Takings, and Due Process*, 37 WASH. & LEE L. REV. 1057 (1980) (arguing cogently that regulatory takings law should be seen as having two divergent strands: that of *Mugler*’s clear but harsh no compensation rule and that of *Mahon*’s more generous but ultimately undefinable rule that government regulation cannot go “too far,” in the words of Justice Holmes). Compare *Mahon*, 260 U.S. at 393-415 with *Los Angeles Gas & Elec.*, 251 U.S. at 38 (reasoning, in a Contracts Clause case, that “But there is some point where power or rights must prevail, however plausible or specious the argument of either against the other may be.”). *Mugler*’s roots can be traced farther back, for example, to *West River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507 (1848) (finding no government liability for condemning a bridge because the grantees took the contract/charter, as are all private rights, subject to the state’s power of eminent domain). For a later example, see *Union Bridge Co. v. United States*, 204 U.S. 364 (1907) (holding no taking where the War Department required modifications to a bridge because the order was pursuant to constitutional power).

the Court heard far fewer reserved powers cases than regulatory takings. By 1977, when the Court decided *United States Trust Co. v. New Jersey*,<sup>60</sup> it noted the mixed precedent on the reserved powers doctrine and relied instead on the analysis from the 1934 landmark decision in *Home Building & Loan Ass'n v. Blaisdell*.<sup>61</sup> *Blaisdell* developed five factors to scrutinize the importance of the public purpose in the legislation and how closely tailored it was to achieving that purpose and avoiding unnecessary infringement on contract rights. In analyzing the reserved powers doctrine, the Court in *United States Trust* called the states' promise regarding the Port Authority bonds at issue "purely financial" and not included in the protection of the doctrine.<sup>62</sup> Of course, taxation is purely a financial matter also, and the Court did no better than *Stone* in distinguishing taxation from a police power.<sup>63</sup> Instead, the Court's analysis focused on the importance of the legislative goals and their logical connection to the means chosen to implement them.<sup>64</sup>

The reserved powers doctrine is essentially an artifact of legal history.<sup>65</sup> This is fortunate in light of the harshness of the rule from *Stone* and the definitional pressure that would result from leaving *Stone* alone while the Court has moved away from *Mugler*. *Stone*'s reliance on a formalistic definition created potential for police power under the Contracts Clause to evolve away from police power under the Takings Clause, and such divergence would encourage plaintiffs to repackage regulatory takings claims as Contracts Clause claims or vice versa. In this respect, both

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<sup>60</sup> *United States Trust Co. v. New Jersey*, 431 U.S. 1 (striking down a New Jersey statute affecting Port Authority bonds as a violation of the Contracts Clause), *reh'g denied*, 431 U.S. 975 (1977).

<sup>61</sup> *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934) (upholding a Minnesota statute that gave a temporary extension to debtors facing repossession of collateral).

<sup>62</sup> See *United States Trust Co.*, 431 U.S. at 25.

<sup>63</sup> I argue in Part II that the different treatment for municipal bonds owes more to the distinction between sovereign and proprietary functions of government.

<sup>64</sup> See *United States Trust Co.*, 431 U.S. at 28-32.

<sup>65</sup> *But cf.* J.D.B. Mitchell, *The Treatment of Public Contracts in the United States*, 9 U. TORONTO L.J. 194, 200-01, 218 (1952) [hereinafter Mitchell, *The Treatment of Public Contracts*] (defending the coherence of the police powers category). Mitchell, however, focuses his analysis on the subsequent legislation that causes the infringement, instead of looking to the original agreement and the governmental power involved there. The subsequent legislation is much more likely to appear within the definition of a police power since the government is not likely to infringe on a contract by signing another.

*Blaisdell* and *United States Trust* should be seen as advancing the jurisprudence, even if only because they analyze the reasons behind, and effects of, the legal rules; they do not purport to be deciding a purely definitional question when the definitional question necessarily decides the case. In the end, the most interesting legacy of *Stone* is probably the historical insights to be drawn from the hostility with which the reconstructed state government—and the Supreme Court—treated the laws enacted by the “provisional”<sup>66</sup> state government.<sup>67</sup>

Nevertheless, the government raised the reserved powers doctrine as one of its three (or four) defenses to liability in *Winstar*. The government’s reserved powers argument relied on *Stone* and similar Contracts Clause cases involving alleged infringements by state governments. At first glance, it seems odd that the government did not cite *Veix*, nor explain specifically how thrift regulation fit under the police power. The concern might have been that the police power per se necessarily pertained to state governments, not the federal government. To avoid this trap, the government may have thought it better to rely on the cases’ language explicating the nature of “sovereign” power.

None of the four justices writing opinions in *Winstar* took the reserved powers argument seriously. Writing for the plurality, Souter dismissed the government’s “two related contentions on the score of *ultra vires*”<sup>68</sup> by referring back to the same analysis he used for the unmistakability defense.<sup>69</sup> Breyer did not discuss reserved powers at all. Scalia waved it off by taking advantage of the formalistic definition of police power: “I do not believe that regulatory measures designed to minimize what are essentially assumed commercial risks are the sort of ‘police power’ or ‘paramount power’ referred to.”<sup>70</sup> In his dissent, Chief Justice Rehnquist ignored the reserved powers doctrine. Because Souter and Scalia (seven votes together) distinguished *Stone* instead of overruling it, the reserved powers doctrine might technically be considered viable. In the interests of clearing away

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<sup>66</sup> *Stone v. Mississippi*, 101 U.S. 814, 819 (1880).

<sup>67</sup> Cf. Sterk, *supra* note 43, at 679-82 (discussing the states’ post Civil War financial obligations). But see Griffith, *supra* note 43, at 297 (not discussing the historical context and concluding that the “Court’s decision was grounded in political theory: power resides in the people, and the legislators as their representatives cannot abdicate that power by entering into long-term contracts that, at some point, cease to carry out the popular will”).

<sup>68</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 888 (1996).

<sup>69</sup> *See id.*

<sup>70</sup> *Id.* at 923. Nor does Scalia explain how a government’s “commercial” powers are different from sovereign powers. *See infra* Part II.

doctrinal detritus, however, it seems preferable to read *Winstar* as overturning *Stone*. The limits of the doctrine are doomed to remain fuzzy and flexible, and the interests of both the government and private parties seem well balanced and protected by the other defenses at issue in *Winstar*. This Article next analyzes the express delegation and the unmistakability doctrines. The government's brief and the Court treated these two defenses separately, but I make the case that they are better understood in comparison with one another.

### C. *Unmistakability Doctrine*

The unmistakability doctrine treats regulatory agreements as contracts but tacks onto contract law the proviso that the government cannot be held to a contract regarding its sovereign powers unless the provision limiting future use of a sovereign power is unmistakably clear. By doing so, the doctrine attempts to balance the majority's right to change the law in the future with the reliance interests of the individual who reached the agreement with the government. The contractual analysis, however, reduces the sovereign perspective on regulatory agreements to an exception within the law of contract. This formulation fails to address the clash between the legal standards more naturally associated with the sovereign perspective, especially those arising in economic due process jurisprudence, which give the government much more latitude to update regulatory policies than contract law does.

This Part reviews the relevant cases establishing the unmistakability doctrine to flesh out exactly how the doctrine functions as an interpretive presumption used by the courts to construe regulatory agreements. The cases fall into two broad categories, depending on whether the government involved is state or federal. The state cases rely directly on the Contracts Clause of the Constitution, which does not apply to the federal government. The federal cases, which are fewer, tend to be a bit vague as to their constitutional basis; at least one is actually a takings case. None of the cases depend on a distinction between blocking the implementation of the new law and paying damages for breach of the old agreement—a distinction the *Winstar* plurality invents to distinguish the federal cases. The plurality's use of this distinction, and discussion of only the federal cases, raises deep questions about the reach of its rule. Does it overrule any of the state cases? Does the *Winstar* rule apply only to regulatory agreements of the federal government?

This Section offers a synthesis of the alternative rules put forth by the majority opinions and criticizes the rule. For not only is the new rule a cynical warp of existing precedent, it is so open-ended as to threaten

damages for any change in regulatory policies. This regime—the equivalent of an extreme version of conservative regulatory takings theory—would destabilize the law of takings and economic due process as well.

### 1. *Unmistakability Doctrine Cases*

Analyzing the major unmistakability cases reveals three significant themes in the case law. First, although the interpretive presumption was initially used more as a way to interpret words in corporate charters that were subject to multiple meanings, courts eventually used the interpretive presumption more in cases where the charters were silent as to whether the government agreed to maintain a particular regulatory policy. The high point in this use of the unmistakability doctrine is probably *Rogers Park Water Co. v. Fergus*,<sup>71</sup> discussed below. The second major theme is that the cases never succeed in defining the threshold issue of when the unmistakability doctrine does apply. The cases are split along two lines, and the opinions do not engage in a useful dialogue that might help clarify the threshold issue. Third, the Supreme Court has applied the unmistakability doctrine to a few cases involving agreements between agencies of the federal government and Indian tribes. These cases describe the unmistakability doctrine as equally applicable to all levels of government, but again, there are other cases that emphasize the different standards states face under the Contracts Clause. This creates another dimension of pressure in the jurisprudence to define the distinction between the areas where the state and federal governments enjoy the same unmistakability defense and where they do not.

#### a. *Strength of the Interpretive Presumption*

The Supreme Court first relied on an unmistakability presumption in *Charles River Bridge Co. v. Warren Bridge Co.*,<sup>72</sup> even though the Court did not label it as such. In this famous case, the Court found no violation of the Contracts Clause when the state of Massachusetts granted a charter to the defendant, Warren Bridge Company, to build a bridge over the Charles River in 1828. The plaintiff, the Charles River Bridge Company, had been chartered by the legislature in 1785 and granted authority to charge tolls on the bridge for forty years (extended in 1792 to seventy

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<sup>71</sup> *Rogers Park Water Co. v. Fergus*, 180 U.S. 624 (1901).

<sup>72</sup> *Charles River Bridge Co. v. Warren Bridge Co.*, 36 U.S. (11 Pet.) 420 (1837).



years). The Warren Bridge Company subsequently built a bridge 800 feet away from the plaintiff's bridge, and though the new bridge initially charged a toll, it soon became free to cross. The Charles River Bridge Company sued for damages and an injunction on the theory that its charter was meant to be exclusive and had been made worthless by the new free bridge.<sup>73</sup>

Plaintiff's charter apparently contained no language on exclusivity, but it should be noted that as general incorporation laws had not yet been passed in Massachusetts, any corporate charter implied at least some form of protection from competition. Justice Story, in dissent, agreed with the implication of monopoly protection and would have struck down the second company's charter.<sup>74</sup> However, Justice Taney, writing for the Court, rejected the implication of monopoly protection, writing that "in grants by the public nothing passes by implication."<sup>75</sup>

Taney also noted that the 1792 legislation that extended plaintiff's charter from forty to seventy years also included a provision permitting construction of another bridge one to two miles away.<sup>76</sup> Taney argues that this is evidence that "the State"<sup>77</sup> did not bargain away its power to charter a competing bridge. Under this logic, then, the presumption necessary to properly interpret the charter was not very strong. While it seems somewhat problematic to rely on a different legislature to interpret the original act,<sup>78</sup> Taney lessened this criticism considerably by noting that only seven years had passed and that even the original forty-year term still had a long time to run,<sup>79</sup> implying that the 1792 legislature was essentially as disinterested as the 1785 legislature (unlike the 1828 legislature, which presumably was feeling pressure from a community having to rely on one inadequate bridge). As an example of the unmistakability doctrine, the interpretive presumption applied by the Court in *Charles River Bridge* was

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<sup>73</sup> See *id.* at 426-27.

<sup>74</sup> See *id.* at 586-87 (Story, J., dissenting).

<sup>75</sup> *Id.* at 546. Story noted:

[I]t would present a singular spectacle if, while the courts in England are restraining, within the strictest limits, the spirit of monopoly, and exclusive privileges in nature of monopolies, and confining corporations to the privileges plainly given to them in their charter, the courts of this country should be found enlarging these privileges by implication[.]

*Id.* at 545-46.

<sup>76</sup> See *id.* at 550-51.

<sup>77</sup> *Id.* at 550.

<sup>78</sup> Cf. Sterk, *supra* note 43, at 647.

<sup>79</sup> See *Charles River Bridge*, 36 U.S. (11 Pet.) at 550.

not very strong. Subsequent cases often involved more ambiguous language in corporate charters, and therefore resulted in application of stronger presumptions.

The Court in *Vicksburg, Shreveport & Pacific Railroad v. Dennis*<sup>80</sup> confronted a typical question in unmistakability cases: whether a tax exemption granted as part of a corporate charter meant the state had bargained away its power to tax the corporation later. Plaintiff's charter provided that the railroad would be exempt from taxation "for ten years after the completion of said road."<sup>81</sup> The state later passed a new tax on the company, which had not yet completed the railroad.<sup>82</sup> The Court upheld the new tax after it applied an unmistakability presumption and found that the exemption did not *begin* to run until completion of the railroad.<sup>83</sup> The Court noted that the exemption did not say "until ten years after the completion."<sup>84</sup> Justice Field, leading a four-vote dissent, argued that it was illogical to deny the tax exemption when the corporation is in its "infancy" and could least afford the tax.<sup>85</sup> Because it is highly likely that Field was correct that the tax break was designed to help the young company along during its inevitably difficult initial period of low revenue (or *no* revenue), the majority's interpretive presumption should be seen as strong enough to overcome a reasonably strong policy argument.

Another example of a tax exemption case is *Covington v. Kentucky*,<sup>86</sup> which upheld a state property tax on the city's waterworks, despite an earlier law providing that the waterworks "shall be and remain forever exempt from state, county, and city tax."<sup>87</sup> Justice Harlan applied an unmistakability standard, based both on the cases then comprising the unmistakability doctrine and on a general provision of Kentucky law which provided that all charters were granted subject to the state's reservation of power "unless a contrary intent be therein plainly expressed."<sup>88</sup> Harlan interpreted the "forever" provision as merely lacking a built-in expiration date for the tax exemption:

The utmost that can be said is that it may be inferred from the terms in which the exemption was declared, that the legislature had no purpose at

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<sup>80</sup> *Vicksburg, Shreveport & Pacific R.R. v. Dennis*, 116 U.S. 665 (1886).

<sup>81</sup> *Id.* at 665.

<sup>82</sup> Construction was delayed by the Civil War. *See id.* at 666.

<sup>83</sup> *See id.* at 667.

<sup>84</sup> *Id.* at 670.

<sup>85</sup> *See id.* at 671.

<sup>86</sup> *Covington v. Kentucky*, 173 U.S. 231 (1899).

<sup>87</sup> *Id.* at 233.

<sup>88</sup> *Id.* at 234.

the time [the tax exemption] was passed to withdraw the exemption from taxation; not that the power reserved would never be exerted, so far as taxation was concerned, if in the judgment of the legislature the public interests required that to be done.<sup>89</sup>

Other tax exemption cases finding in favor of the government typically involve slightly weaker presumptions, as other facts provide independent support for the government's interpretation.<sup>90</sup>

Another bridge case, with facts very similar to *Charles River Bridge*, presents an extreme example of using the unmistakability presumption to interpret particular language. In *Bridge Proprietors v. Hoboken Co.*,<sup>91</sup> the Court found no violation of the Contracts Clause where the plaintiffs had obtained a ninety-nine year charter that barred "any other bridge" from being built near plaintiff's bridge.<sup>92</sup> Seventy years later, the defendant city granted a competing charter to build a nearby railroad bridge.<sup>93</sup>

A period of time equal to three generations of the human race has elapsed. During that time the progress of the world in arts and sciences has been rapid. In no department of human enterprise have more radical changes been made, than in that which relates to the means of transportation of persons and property from one point to another, including the means of crossing watercourses, large and small.<sup>94</sup>

The Court went on to concluded that the term "bridge" in the original charter did not include railroad bridges:

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<sup>89</sup> *Id.* at 239. Harlan went on to find that the tax exemption was not a contract within the meaning of the Contracts Clause because a city's purposes are necessarily public, not private, and therefore its charter from the state does not give it private contractual rights protected by the Constitution. *See id.* at 241-42.

<sup>90</sup> *See, e.g.,* *Metropolitan Street Ry. v. New York State Bd. of Tax Com'rs*, 199 U.S. 1 (1905) (upholding a new tax on a railroad company whose charter required ongoing payments into a state-administered sinking fund); *Minot v. Philadelphia, Wilmington & Baltimore Ry.*, 85 U.S. (18 Wall.) 206 (1874) ("*Delaware Ry. Tax Case*") (upholding a tax on an interstate corporation which resulted from a merger of Maryland and Pennsylvania corporations, where the charter of one of the original corporations included a tax exemption and the language in both states' legislation approving the merger granted the combined entity "all rights" of the original companies); *Chesapeake & Ohio Ry. v. Miller*, 114 U.S. 176 (1885) (similar).

<sup>91</sup> *Bridge Proprietors v. Hoboken Co.*, 68 U.S. (1 Wall.) 116 (1883).

<sup>92</sup> *See id.* at 146.

<sup>93</sup> *See id.* at 118.

<sup>94</sup> *Id.* at 146.

Yet the structure which the defendants propose to build over the Hackensack is not more like a bridge of the olden time than a railroad is like one of its roads, or a railroad coach is like one of its coaches. It is not, then, a necessary inference, that because the word "bridge" may now be applied by common usage to the structure of the defendants, that it was therefore the thing intended by the act of 1790.<sup>95</sup>

If the passage of three generations suffices to apply such a strained interpretation of the word "bridge," then the Court seems to be saying that any similarly long-term grant will be subject to a similarly strict construction. Nonetheless, it is difficult to extract from cases like *Hoboken* a more general description of how strong the unmistakability presumption should be when applied to different charters because, at least in part, the variety of language and factual contexts makes the fairness claims of the plaintiff companies difficult to categorize.

Somewhat easier to generalize are the interpretive presumptions arising out of cases setting rates for utility companies. The best example might be *Rogers Park Water Co. v. Fergus*,<sup>96</sup> where the water company's charter, running for thirty years, included a schedule of rates requiring the company to "charge the following annual water rates to consumers of water during the existence of this franchise[.]"<sup>97</sup> Nine years later, the city government reduced the maximum rates and the water company refused to provide water at the lower rates.<sup>98</sup> The city sued "to compel [the water company] to furnish [ ] water at rates fixed by ordinance."<sup>99</sup> The case is unusual in that it is the city bringing the action and relying on a contract theory. The city's *offensive* use of the unmistakability doctrine is somewhat remarkable. The Court upheld the new lower rates, reasoning, that "[a] strict construction must be exercised. The contract claimed concerned governmental functions, and such functions cannot be held to have been stipulated away by doubtful or ambiguous provisions."<sup>100</sup> There is some ambiguity within the quoted language from the charter, in the sense that some of the words in the key provision have dual meanings. The ambiguity relied upon by the

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<sup>95</sup> *Id.* at 148.

<sup>96</sup> *Rogers Park Water Co. v. Fergus*, 180 U.S. 624 (1901).

<sup>97</sup> *Id.* at 626.

<sup>98</sup> *See id.* at 625. In the interim, the city was annexed by Chicago, which imposed the new rates.

<sup>99</sup> *Id.* at 624. Note that the Court did not use the expression "specific performance."

<sup>100</sup> *Id.* at 628-29.

Court in *Rogers Park* arises instead from an ambiguity present in virtually all charters that set rates: does the provision bind both the city and the company or only the company? Indeed, Justice White argued in dissent that the quoted phrase contained no ambiguity: “there can be no doubt, *from a consideration of the text of the contract*, that it fixed the rates to be paid by private consumers during the life of the contract.”<sup>101</sup> But the majority’s reasoning requires more: whenever “governmental functions” are at issue, for a charter provision to bind the city, the provision must use unmistakably clear language that the government’s power to change its regulation has been bargained away.<sup>102</sup> Apparently this would require language to the effect that: “The city shall not set new rates for the next thirty years.” A good example of such language appears in *Los Angeles v. Los Angeles City Water Co.*,<sup>103</sup> which struck down new, lower rates where the city had initially promised that it “shall not so reduce such water rates . . . less than those now charged.”<sup>104</sup> The general applicability of the presumption in *Rogers Park* and similar cases makes them not only powerful, but also the most coherent examples of the unmistakability doctrine.<sup>105</sup> Indeed, the comparison between *Rogers Park* and *Los Angeles City Water* should be understood as the paradigmatic example of the unmistakability doctrine.

In sum, the state unmistakability cases generally fall into one of two rough categories. First, there are the cases like *Vicksburg, Shreveport & Pacific Railroad* and *Hoboken* that involve interpretation of ambiguous phrases in the charter. The ambiguity in these cases is easier to locate in specific phrases, but it is difficult to generalize the strength of the interpretive presumption used in these cases because the level of ambiguity varies and the holdings seem so inconsistent. Then, there are cases like *Rogers Park*, which are a little easier to describe as a category because the

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<sup>101</sup> *Id.* at 632 (White, J., dissenting) (emphasis added).

<sup>102</sup> *See id.* at 628-29.

<sup>103</sup> *Los Angeles v. Los Angeles City Water Co.*, 177 U.S. 558 (1900).

<sup>104</sup> *Id.* at 560.

<sup>105</sup> In addition to *Rogers Park*, the Court also decided two similar cases the same day, all three finding for the government by the same 5-4 vote: *Danville Water Co. v. Danville*, 180 U.S. 619 (1901); and *Freeport Water Co. v. Freeport*, 180 U.S. 587 (1901). *Freeport Water* is similar to *Vicksburg Shreveport & Pacific Railroad* in that the ambiguity appeared in a particular phrase in the charter. *Freeport* authorized the water company to provide water to residents “at such rates as may be fixed by ordinance, and for a period not exceeding thirty years.” *Id.* at 600. Applying the unmistakability doctrine’s presumption, the Court read “and for a period” as referring only to the duration of the grant of authority and not to the “rates as may be fixed by ordinance.” *Id.*

so-called ambiguity is not specific to certain ambiguous words or phrases. When the same charter provision both grants a power to a company, for example, to charge for water, and also regulates that power, the *Rogers Park* line of cases reads it as ambiguous whether the government merely recognized the power or also confined future government regulation of the power to the given limits. This ambiguity exists in most charters that include regulatory provisions.<sup>106</sup> If one sees the franchising ordinance or statute as a contract, the natural reading is that its provisions bind both parties. If one views it as a statement of government regulation, the more plausible reading is that the government may subsequently alter its regulation. Since the interpretive decision to treat the ordinance or statute as a contract necessarily imports the bias that its provisions bind both parties, the unmistakability doctrine can be thought of as requiring a certain hesitation before reading ordinances or statutes as contracts, or at least as binding the government party in the same way as it binds the private party.

*b. Failure to Define When Unmistakability Doctrine Applies*

The Supreme Court, however, has not applied the unmistakability doctrine consistently, and this obviously makes it difficult to summarize the strength of the interpretive presumption completely. In several cases, the Court seems to ignore the defense (perhaps because it was not argued) and apply instead a tacit assumption that the government must live by the same contracting rules that apply between private parties. This assumption is what Professor Schwartz dubbed “congruence.”<sup>107</sup> A good example is *Cleveland v. Cleveland City Railway*,<sup>108</sup> where the Court struck down a city ordinance requiring a local train company to reduce its rates to four cents. The company’s charter, which resulted from consolidations of three smaller railroads, set maximum fares at five cents but contained no language that the city was surrendering its powers to set new rates.<sup>109</sup> Indeed, one of the three earlier company’s charter expressly reserved to the city the power to decrease fares,<sup>110</sup> but the Court explained that the lack of a similar reservation in the combined company’s charter was one the three factors

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<sup>106</sup> This may be one reason why states have moved away from regulating corporations through charter language and instead allow broadly written corporate charters and provide for regulation of corporations via separate statutes.

<sup>107</sup> Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 633.

<sup>108</sup> *Cleveland v. Cleveland City Ry.*, 194 U.S. 517 (1904).

<sup>109</sup> *See id.* at 524-27 (describing the various constituent charters and the ordinances approving their consolidations).

<sup>110</sup> *See id.* at 524.

that convinced it that the five-cents fare bound the city.<sup>111</sup> Hence, *Cleveland City Railway* presumes no reservation of power by the city unless the charter expressly reserves it. *Rogers Park* makes precisely the opposite presumption: that the city does not lose a power unless the charter includes express language of surrender. The Court in *Cleveland City Railway* neither cites nor distinguishes *Rogers Park* or any of the other similar unmistakability cases. Instead, the Court in *Cleveland City Railway* relied on another case that did not discuss the unmistakability doctrine.<sup>112</sup> The lack of dialogue is unfortunately typical between cases upholding subsequent government changes in regulatory treatment, which I shall refer to as “unmistakability cases,” and cases striking them down, which I shall refer to as “utility congruence cases.”<sup>113</sup>

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<sup>111</sup> See *id.* at 536. The two other reasons were that rates were “fixed in ordinances for a stated time” and that the city required “written acceptance by the corporations of the ordinances.” *Id.*

<sup>112</sup> See *id.* (citing *Detroit v. Detroit Citizens’ St. Ry.*, 184 U.S. 368 (1902)).

<sup>113</sup> Utility congruence cases striking down new regulation include: *Appleby v. Delaney*, 271 U.S. 403 (1926) (a good example of pure congruence analysis); *Vicksburg v. Vicksburg Waterworks Co.*, 206 U.S. 496 (1907) (holding that a thirty-year franchise granted by the city and setting water rates was a binding contract on the state); *Detroit Citizens’*, 184 U.S. at 368 (invalidating a subsequent ordinance requiring lower rates); *New Orleans Gas Co. v. Louisiana Light Co.*, 115 U.S. 650 (1885) (holding an “exclusive” charter prevails even against a change to the state constitution); *New Orleans Water Works Co. v. Rivers*, 115 U.S. 674 (1885) (same as *New Orleans Gas*). Cf. *Walla Walla v. Walla Walla Water Co.*, 172 U.S. 1 (1898) (granting an injunction against the city, which argued that the Contracts Clause did not apply because the city acted in a private capacity in contracting with the company to provide water). *Walla Walla* is probably best understood as an example of a city outsmarting itself in arguing its case.

Other unmistakability cases upholding changes to regulation include: *Keefe v. Clark*, 322 U.S. 393 (1944) (finding no violation of the Contracts Clause); *St. Louis v. United R.R.*, 210 U.S. 266 (1908) (finding no contractual obligation to avoid taxing the railroad company); *Owensboro v. Owensboro Waterworks Co.*, 191 U.S. 358 (1903) (ruling that the franchise authorized the company to “make and enforce . . . all needed rules and regulations not inconsistent with the law, or provisions of this ordinance”); *Chicago, B&Q Ry. v. Nebraska*, 170 U.S. 57, 72 (1898) (holding that the contract loses out to subsequent legislation); *New Orleans City & Lake Ry. v. New Orleans*, 143 U.S. 192 (1892) (upholding a new tax on the company despite charter language that provided for certain taxes and expressly promised that the city would not charter rival railroads until 1906); *Pennsylvania Ry. v. Miller*, 132 U.S. 75, 84 (1889) (rejecting, on essentially unmistakability theory, the railroad’s argument that its acknowledged power to condemn certain property necessarily

Of course, inconsistency in the Contracts Clause interpretations generally, and unmistakability in particular, traces back to *Charles River Bridge* and the difficulty in reconciling it with the earlier decision in *Dartmouth College v. Woodward*.<sup>114</sup> Even more inconsistent with *Charles River Bridge* is the later decision in *Chenango Bridge Co. v. Binghamton Bridge Co.*,<sup>115</sup> which granted an injunction and an accounting in damages against a competing bridge company, despite strong similarities to the facts of *Charles River Bridge*. Plaintiff Chenango Bridge Company received a charter in 1808, with an unlimited term, and protection from competing bridges within two miles.<sup>116</sup> Justice Davis, writing for the majority in *Chenango Bridge*, cited *Dartmouth College* as controlling and found the charter's competition protection clause dispositive. The majority had "no doubt" that the legislature spoke clearly in declaring: "That it shall not be lawful for any person or persons to erect any bridge . . . within two miles, either above or below the bridges, to be erected and maintained in

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included immunity from tort liability arising from the nuisance of its construction site); *Memphis Gas Light Co. v. Taxing District of Shelby County*, 109 U.S. 398 (1883) (holding that no exemption to new tax on company is implied in a charter that set certain rates the company could charge consumers); *Fertilizing Co. v. Hyde Park*, 97 U.S. 659 (1878) (finding no violation in regulation which made fertilizing company charter worthless). Few, if any, state unmistakability cases have been decided since these.

<sup>114</sup> *Dartmouth College v. Woodward*, 4 Wheat. 518 (1819) (holding that Dartmouth's charter from the king is a contract, which New Hampshire cannot alter under the Contracts Clause). For a comparison with *Charles River Bridge*, see, for example, Robert E. Mensel, *Privilege Against Public Right*, 33 DUQ. L. REV. 1 (1994) (analyzing the political pressures behind the *Charles River Bridge* decision). Although I suspect the holdings from *Dartmouth College* and *Charles River Bridge* are not reconcilable, it is perhaps an underappreciated fact that the trustees of Dartmouth College could not claim the protection of the Takings Clause (even if it had already been applied to the states) because they were not owners in the sense that they held stock or ownership rights and so they had no property interest per se at stake. This would suggest that the college's only protection would be through the Contracts Clause, but it also makes it unclear what interests of the trustees deserved judicial protection.

<sup>115</sup> *Chenango Bridge Co. v. Binghamton Bridge Co.*, 70 U.S. (3 Wall.) 51 (1865).

<sup>116</sup> *See id.* at 53, 55. The charter language referred to another charter with a two-mile protection, even though the two-mile limit might not have made perfect sense for the Chenango Bridge Company, in light of the fact that the Chenango River flowed only a quarter mile downstream from the bridge before emptying into the Susquehanna River. *Id.* at 83 (Grier, J., dissenting).



pursuance of this act.”<sup>117</sup> Although the Court also cited *Charles River Bridge*, it essentially ignored the question of whether the legislature meant to bind itself in competition-protection clause. In contrast, the New York Court of Appeals read the charter language as barring only “individuals, public officers and authorities and other corporations [from building competing bridges], and [the language] was not intended to be or to constitute any restriction on the sovereignty of the state[.]”<sup>118</sup> The state court’s reluctance to bind the legislature is a good example of how the unmistakability doctrine operates as an interpretative tool; the Supreme Court’s treatment is a good example of a tacit presumption of congruence.

Certainly, the unmistakability cases vary in the strength of the interpretive presumption they employ, but the more important difficulty is distinguishing when they apply at all, and when, instead, the utility congruence cases, like *Detroit Citizens’* and *Cleveland City Railway*, apply. Because the unmistakability doctrine aims to protect the government’s ability to enact new laws without incurring contract liability, it makes sense for the unmistakability doctrine to apply only if exercise (or restraint) of a sovereign power is allegedly part of the disputed agreement. Unfortunately, both the unmistakability and utility congruence cases avoid directly analyzing this threshold issue. *Rogers Park* is again a good example. The majority asserts that the regulation of water rates is a sovereign power and therefore applies the unmistakability doctrine: “The contract claimed concerned *governmental functions*, and such functions cannot be held to have been stipulated away by doubtful or ambiguous provisions.”<sup>119</sup> The problem with the “governmental functions” language is that the city in *Cleveland City Railway* undoubtedly exercised a governmental function when it made a binding contract with the local railroad and the Court did *not* apply the unmistakability doctrine. Governmental functions would seem to include acting in a private capacity, so the phrase does quite a bit less than it might first seem to explain why *Rogers Park* favors the government. The *Rogers Park* dissenters similarly avoid the threshold issue and instead simply assume that private contracting rules apply to the government in all agreements made by the government:

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<sup>117</sup> *Id.* at 78.

<sup>118</sup> *Chenango Bridge Co. v. Binghamton Bridge Co.*, 70 U.S. (3 Wall.) 137, 138 (1865) (Reporter’s Notes to Case).

<sup>119</sup> *Rogers Park Water Co. v. Fergus*, 180 U.S. 624, 628-29 (1901) (emphasis added); *see also* *County of Stanislaus v. San Joaquin & King’s River Canal & Irrigation Co.*, 192 U.S. 201, 210-11 (1904) (“To regulate or establish rates for which water will be supplied is in its nature the execution of one of the *powers of the State*. . . .”) (emphasis added).

Can it, in reason, be said, in view of the terms of the contract, that if the water company had wished to charge more than the contract price, on the ground that an unreasonably low sum had been fixed in the contract, it would have had a right at once to ignore the contract stipulation and exact higher rates? If it cannot be, how can it be held that the city had the right at its pleasure to disregard the rates fixed in the contract? *Was not the obligation of one the correlative of the right of the other?*<sup>120</sup>

Avoiding the issue allows the dissent to use powerfully coherent rhetoric that follows from the tacit assumption of congruence. If the dissenters were to acknowledge the possibility that government contracts are different from private contracts, the dissent would immediately face a difficult question of when and why government contracts would be different. The majority, of course, faces the reverse dilemma. To argue that different rules apply to government agreements could imply that these agreements are not contracts at all. This radical implication immediately raises two difficult analytical problems: (1) if the charter is not a contract, what is it?; (2) on what theory, and under what circumstances, would the government ever be bound by its provisions?

Perhaps the closest the broader jurisprudence came to rationalizing the cases was to distinguish the sovereign role of the government from its corporate, proprietary, or business role. Actions in the latter role are binding under the traditional rules of contracts: "If [government] comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there."<sup>121</sup> But the distinction was never fully developed and rarely appeared in the unmistakability cases. Especially for municipal governments,<sup>122</sup> the distinction can

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<sup>120</sup> *Rogers Park Water Co. v. Fergus*, 180 U.S. 624, 633 (1901) (White, J., dissenting) (emphasis added).

<sup>121</sup> *Cooke v. United States*, 91 U.S. 389, 398 (1875) (holding the government liable to pay on forged commercial paper it accepted and paid for when it did not find the forgery with reasonable speed but was negligently slow); *see also* *Los Angeles v. Los Angeles Gas & Elec. Co.*, 251 U.S. 32, 38-39 (1919) (finding that the city's construction of its own city lights was done in the city's proprietary capacity and therefore did not relieve the city of liability to a company chartered earlier to provide street lights); *Vicksburg v. Vicksburg Waterworks Co.*, 206 U.S. 496, 508 (1907) (noting that "a state may, in matters of proprietary rights, exclude itself from the right to make regulations"); *South Carolina v. United States*, 199 U.S. 437, 461 (1905) (making a similar distinction in upholding a federal tax on the sale of liquor by a state-owned seller).

<sup>122</sup> *See, e.g., Delmar W. Doddridge, The Distinction Between Governmental and Proprietary Functions of Municipal Corporations*, 23 MICH. L. REV. 325 (1925)

become pretty fine, as for example, the difference between regulating the rates at which a water company provides water to residents and contracting with the company to supply water to residents. This threshold difficulty probably explains the inconsistency in the unmistakability case law.

It also reflects a fundamental difference in perspective in the two lines of thought. The utility congruence cases, like *Cleveland City Railway*, start from the premise that the regulatory agreements are contracts and the appropriate analysis therefore looks only to the reasonably ascertainable intent of the contracting parties. It is not necessary to look more broadly to the context in which government operates to arrive at an interpretation of the parties' intentions and, moreover, to do so seems to invite a pro-government result because there is no clear stopping point as to how broad the contextual analysis should extend. This viewpoint seeks to protect not only private parties who rely on government promises, but also the government's reputation as a reliable contracting party.

On the other hand, the unmistakability cases, like *Rogers Park*, generally view the issue as fundamentally about *government* actions, which are necessarily judged in a broader context than simply the contractual intent of the parties. Governmental actions must be evaluated in terms of how the rules regulating the actions improve or restrict democratic processes. This viewpoint implicitly seeks to avoid saddling the community with bad bargains agreed to by long-dead legislators and businessmen. Regulatory agreements, as I have defined them, are fundamentally both agreements between parties and exercises of sovereign authority. Fortunately, the express delegation doctrine<sup>123</sup> provides some help by looking to the government entities' authorizing statutes and distinguishing between the authority to *regulate* rates and the authority to *contract* for certain rates.

This distinction between whether the state acts as a sovereign or as a private party has made a difference in the scrutiny the state will face in defending subsequent legislation against a constitutional challenge based on the Contracts Clause. For if the state's promises constitute actions in its sovereign capacity, the state need only raise the unmistakability defense along the lines of *Rogers Park*, which should make it easy for the state to escape liability for the subsequent legislation. If, however, the state's promises related to actions that put the state in the same position as a private contracting party, then there is little reason to think the state could escape *Home Building & Loan Ass'n v. Blaisdell*<sup>124</sup> and its progeny, which

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(listing six areas of law that make the distinction and criticizing the coherence of each).

<sup>123</sup> See *infra* Part I.D.

<sup>124</sup> *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934).

require the state to justify both the breaching legislation's goals and the means the statute applies to reach those goals.

*Blaisdell* upheld a Minnesota statute that gave temporary extensions to indebted farmers who faced repossession of their farms during the early years of the Depression. The Court nevertheless imposed a high standard of review, upholding the statute only after finding it met five factors: (1) the economic conditions constituted an emergency, (2) "the legislation was not for the mere advantage of particular individuals but for the protection of a basic interest of society,"<sup>125</sup> (3) the specific "relief afforded . . . [was] appropriate to that emergency and could be granted only upon reasonable conditions,"<sup>126</sup> (4) the conditions for extensions were reasonable, and (5) the extensions would only be available during the emergency and the legislation expired shortly anyway.<sup>127</sup> While *Blaisdell* has attracted a great deal of criticism, especially for its infidelity to the original understanding of the Contracts Clause,<sup>128</sup> the important point here is that *Blaisdell*'s five-part test, and subsequent Contracts Clause decisions, make it relatively difficult for a state to escape liability compared to the unmistakability standard from *Rogers Park*.

More recent decisions have weakened *Blaisdell*'s standard somewhat, though the precise rule is difficult to pin down due to subsequent conflicting decisions. *Allied Structural Steel Co. v. Spannaus*<sup>129</sup> struck down a Minnesota law requiring companies to fund the pension plans of their employees if the companies closed offices in Minnesota. *Spannaus* analyzed the nexus between the purposes of the legislation and the ends chosen to reach the goal and applied a sliding scale test.<sup>130</sup> The Court found the impairment severe because the company's contract with its employees specifically exempted the company from the obligation to fund the pension plan.<sup>131</sup> *Energy Reserves Group, Inc. v. Kansas Power & Light*

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<sup>125</sup> *Id.* at 444-45.

<sup>126</sup> *Id.*

<sup>127</sup> *See id.* at 445-47.

<sup>128</sup> *See, e.g.,* Richard A. Epstein, *Toward a Revitalization of the Contracts Clause*, 51 U. CHI. L. REV. 703, 735-36 (1984).

<sup>129</sup> *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978).

<sup>130</sup> *See, e.g., id.* at 245 ("The severity of the impairment measures the height of the hurdle the state legislation must clear."). This means-ends nexus analysis tends to result in highly manipulable judicial tests. *Accord* Richard E. Levy, *Escaping Lochner's Shadow: Toward a Coherent Jurisprudence of Economic Rights*, 73 N.C. L. REV. 329 (1995) (criticizing this form of analysis in cases such as *Lochner* and *Spannaus*, among others).

<sup>131</sup> *See Spannaus*, 438 U.S. at 246.

*Co.*<sup>132</sup> upheld a Kansas statute resetting price ceilings on natural gas. The Court in *Energy Reserves* unanimously found there were no contractual rights impaired because the parties explicitly recognized the variability of government regulation of price controls.<sup>133</sup> *Exxon Corp. v. Eagerton*<sup>134</sup> upheld a law preventing tax increases from being passed on from oil and gas producers to purchasers despite the private parties' contracts allowing it. The Court found that the prohibition on the "pass-through" affected all producers, not just those with contracts, and so declared the pass-through prohibition "generally applicable" and therefore permissible.<sup>135</sup> These recent Contracts Clause decisions certainly suggest a much more permissive analysis than *Blaisdell*, but they still represent an intermediate level of scrutiny compared to the presumption from *Rogers Park* and the unmistakability cases. The critical step in the analysis is thus still the initial determination of which standard to apply to the subsequent government action.<sup>136</sup> This decision implicitly turns on whether the initial government promises constitute sovereign or private actions.

The state unmistakability cases exhibit three themes. First, the early unmistakability cases interpret ambiguous phrases, but eventually the main line of cases follow the *Rogers Park* model: silence on the question of whether a governmental unit is bound is read as ambiguous and the state is given the benefit of the ambiguity. To hold the governmental unit to an alleged promise concerning its exercise of regulatory power, the agreement must use language unmistakably clear, as in *Los Angeles City Water*, where the city promised that it "shall not so reduce such water rates . . . less than those now charged."<sup>137</sup> Second, the state unmistakability cases have a parallel line of cases that treat the governmental units as private contracting parties. The two lines of cases seem to ignore one another, leaving the threshold question of how to determine when to apply the unmistakability doctrine and when to simply treat the state or city as a private party

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<sup>132</sup> *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400 (1983).

<sup>133</sup> *See id.* at 416. The Court also emphasized "the fact that the parties are operating in a heavily regulated industry," which put them on notice of the risk of changes in government regulation. *Id.* at 413.

<sup>134</sup> *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983).

<sup>135</sup> *See id.* at 191.

<sup>136</sup> *But see* GEOFFREY R. STONE ET AL., *CONSTITUTIONAL LAW* 1564 (2d ed. 1991) (suggesting that modern standards for Contracts Clause review are essentially the same as the due process standards); Levy, *supra* note 130, at 371-72 (arguing that *Spannaus* was overruled by *Energy Reserves*).

<sup>137</sup> *Los Angeles v. Los Angeles City Water Co.*, 177 U.S. 558, 560 (1900).

unresolved. Third, the threshold issue divides not only the unmistakability cases but, when one views the jurisprudence more broadly, the rule from *Spannaus* and *Energy Reserves* probably requires more of the government than *Rogers Park*. To the extent these standards diverge, the distinction between the two lines of cases parallels the threshold question that divides *Rogers Park* from *Cleveland City Railway*.

### c. Federal Unmistakability Cases

Although the Supreme Court has had fewer occasions to apply the unmistakability doctrine to agreements made by the federal government,<sup>138</sup> the resulting body of case law reflects similar results, as well as another dimension to the threshold issue. The strongest example of a federal unmistakability case is probably *Merrion v. Jicarilla Apache Tribe*.<sup>139</sup> In *Merrion*, a Native American tribe leased land and oil rights to a developer. The lease prevented the tribe from raising the rent or royalties payments required under the lease but said nothing specifically about taxes. Later the tribe imposed a severance tax on oil production and the developer sued for relief from the tax, claiming breach of the lease.<sup>140</sup> The Court upheld the tax, reasoning that: “[w]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign’s jurisdiction, and will remain intact *unless surrendered in unmistakable terms*.”<sup>141</sup> Two aspects of *Merrion* are important. First, the interpretive presumption necessary to decide *Merrion* is essentially the same as the one from *Rogers Park* because the tribal lease was silent on the issue of taxes. The Court cited a state unmistakability case for the rule: “the government’s power to tax remains unless it ‘has been specifically surrendered in terms which admit of no other reasonable

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<sup>138</sup> Federal unmistakability cases are less common because the federal government rarely grants corporate charters, with the notable exceptions of national banks and federal thrifts, and in the 19th century, a few railroads. *But cf.* Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 500 (arguing that there are so few federal unmistakability cases because the sovereign acts doctrine “occupied” the field and made it unnecessary). As explained below, however, this may lead Schwartz to give too much credence to Justice Scalia’s claim that the unmistakability doctrine and the sovereign acts doctrine really amount to the same thing. *See infra* Part II.A.

<sup>139</sup> *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982).

<sup>140</sup> *See id.* at 135-36.

<sup>141</sup> *Id.* at 148 (emphasis added).

interpretation.’<sup>142</sup> In the two other Supreme Court decisions most often cited as examples of the federal unmistakability doctrine, the interpretive presumption did little to decide the cases because the original agreements contained express reservations of authority for the subsequent legislation.<sup>143</sup>

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<sup>142</sup> *Id.* (quoting *St. Louis v. United R.R.*, 210 U.S. 266, 280 (1908)). *St. Louis* is a typical example of the *Rogers Park* line of cases.

<sup>143</sup> See *United States v. Cherokee Nation*, 480 U.S. 700, 706 (1987) (upholding the government’s exercise of its navigational servitude power); *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986) (“*POSSE*”) (upholding changes to the Social Security Act). In *POSSE*, prior to the contested change, the Social Security Act (“SSA”) gave states the right to join the Social Security System in order to cover state and local employees for old age, disability, and death benefits. States could drop out of the program with two years’ notice. See *id.* at 43-45. After several states withdrew from the system and it appeared likely more would follow, Congress repealed the option of withdraw. See *id.* at 46-48. In rejecting the contractual arguments of the California state agencies, the Court first reasoned that the unmistakability doctrine applied. “[W]e have emphasized that ‘[w]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign’s jurisdiction, and will remain intact unless surrendered in unmistakable terms.’” *Id.* at 52 (quoting *Merrion*, 455 U.S. at 148). However, the Court spent comparatively more time analyzing the SSA’s express reservation of Congress’s authority to “alter, amend, or repeal any provision” of the SSA, and concluded that the SSA therefore “created no contractual rights.” *Id.* at 52 (citing the *Sinking Fund Cases* and *AMTRAK*, discussed *infra* notes 147-153 and accompanying text). Because of this reservation of authority, and the Court’s reliance upon it, *POSSE* adds little to our understanding of the strength of the interpretive presumption because the presumption was not needed to decide the case. But *POSSE* is significant for its sympathetic description of the unmistakability doctrine.

In *Cherokee Nation*, the Court rejected a takings claim brought by tribe for damages done to a riverbed by the Army Corps of Engineers. The tribe purchased the river from the federal government but the government claimed it had retained a navigation easement to the riverbed and therefore had the right to dredge the riverbed to clear a channel without being liable to the tribe for damages. The Court agreed with the government, finding that the Commerce Clause in the Constitution gave the United States implied easements over all navigable waterways. The Court also pointed out, however, that an earlier decision interpreted the same transfer of ownership of the riverbed to the tribe and that the earlier decision included an express statement that the United States had retained such an easement. See *id.* at 706 (quoting *Choctaw Nation v. Oklahoma*, 397 U.S. 620, 635 (1970)). Thus, there was little ambiguity on that issue left for the unmistakability doctrine to interpret and so the case does not represent a powerful interpretive presumption.

Second, the Court in *Merrion* notes that sovereign power, “[w]ithout regard to its source,”<sup>144</sup> is protected by the unmistakability doctrine. The state unmistakability cases saw the doctrine as arising from the Contracts Clause, which provides that “No State shall . . . pass any . . . Law impairing the Obligation of Contracts,”<sup>145</sup> and as solely applicable to state governments. *Merrion* sees the unmistakability doctrine as equally applicable to Indian tribes and presumably the federal government. This should mean that the state unmistakability cases would be, at a minimum, relevant guidance for interpretation of the doctrine, and indeed *Merrion* relies on one of the state unmistakability cases for its unmistakability rule.<sup>146</sup>

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<sup>144</sup> *Merrion*, 455 U.S. at 148.

<sup>145</sup> U.S. CONST., art. I, § 10 (emphasis added).

<sup>146</sup> See *Merrion*, 455 U.S. at 147-48 (citing three cases). The third, *St. Louis v. United Ry.*, 210 U.S. 266 (1908), is a typical unmistakability case firmly in line with *Rogers Park*. The Court also cites *Blaisdell* and *Veix v. Sixth Ward Building & Loan Ass’n*, 310 U.S. 32 (1940). *Blaisdell*, discussed *supra* note 124 and accompanying text, involved private contracts between private parties. *Veix* upheld a state law that restricted the rights of shareholders of a building & loan to redeem their shares. This is also a private contract. The Court reasoned that *Blaisdell* means that the police power extends to economic regulation as well and that the shareholders rights were subject to the police power all along. This combination of reasoning is historically interesting because it marries, albeit awkwardly, the 19th century deference to the police power with the huge expansion of the concept worked by *Blaisdell*.

Justice Stevens dissented in *Merrion*. He did not take issue with the unmistakability doctrine, nor with the Court’s interpretation of the lease per se, but questioned whether the tribe had the inherent authority of taxation. Stevens argued that the tribe’s power to tax was derived from the power to exclude non-Indians from the reservation and, therefore, by granting access to the reservation via a lease, the tribe no longer had sovereign power over the developer. Consequently, the tribe should not be allowed to act as a sovereign by imposing a new tax. See *Merrion*, 455 U.S. at 159 (Stevens, J., dissenting). This is at its core another dispute about the threshold issue of when the unmistakability doctrine should apply. Interestingly, the majority in *Merrion* resolved the threshold issue as determining the government’s role: “Most important, petitioners and the dissent confuse the Tribe’s role as commercial partner with its role as sovereign. This confusion relegates the powers of sovereignty to the bargaining process undertaken in each of the sovereign’s commercial agreements.” *Id.* at 145-46. The majority eventually confronted Stevens’ argument by dissecting the precedents cited by Stevens and concluded that they do not rely “solely [on] the power to exclude” as the basis for tribal sovereignty. See *id.* at 141. So the dispute about the threshold issue of whether the unmistakability doctrine applies is specific to the origins of tribal sovereignty. Unfortunately, the majority does not articulate rules for deciding when



The Supreme Court touched on the issue of whether the federal government faces the same standard as the states in 1879, when it decided two companion cases known as the *Sinking Fund Cases*.<sup>147</sup> During the Civil War, the Whigs were finally able to pass legislation chartering companies to build the intercontinental railroad and open up the West to greater settlement. Congress chartered the Union Pacific. In light of the railroad's heavy reliance on bonds for financing, Congress funded "subsidy" bonds, payable in thirty years. The initial legislation also provided "that Congress may at any time alter, amend, and repeal this act."<sup>148</sup> In 1878, concerned that the railroad's shareholders might divert so much money in dividends as to threaten the railroad's long-term solvency, Congress added a requirement that the railroad establish a sinking fund<sup>149</sup> with the treasury, and mandated that the railroad "deposit" into the fund "half of the earnings for services rendered the Government."<sup>150</sup> The Court upheld the sinking fund requirement against a due process challenge. Justice Waite, writing for the majority, hinted that the same standards applied to both the federal government and state governments despite the wording of the Contracts Clause:

The United States cannot any more than a State interfere with private rights, except for legitimate governmental purposes. They are not included within the constitutional prohibition which prevents States from passing laws impairing the obligation of contracts, but equally with the States they are prohibited from depriving persons or corporations of property without due process of law. They cannot legislate back to themselves, without making compensation, the lands they have given this Corporation to aid in the construction of its railroad.<sup>151</sup>

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a government unit is acting within its governmental role, nor does Stevens offer a competing rule. From this, it seems that the threshold issue remains unresolved in the federal cases. Moreover, *Merrion's* comment that unmistakability applies equally to all levels of government obviously did not command unanimous support.

<sup>147</sup> *Union Pacific Ry. v. Gallatin*, 99 U.S. 700 (1879); *Central Pacific Ry. v. Gallatin*, 99 U.S. 700 (1879).

<sup>148</sup> *Union Pacific*, 99 U.S. at 720.

<sup>149</sup> A sinking fund is essentially a segregated account securing payment of bonds.

<sup>150</sup> *Union Pacific*, 99 U.S. at 726. Note that the other half of such earnings were already required to be paid towards the debt on the subsidy bonds, so the 1878 amendments effectively took this half too. The sinking fund supposedly benefitted all creditors, but it is unclear how much benefit the private bond holders actually received.

<sup>151</sup> *Id.* at 718-19.

If a state were to pass the same law, "it would not be seriously contended that such legislation was unconstitutional, either because it impaired the obligations of the charter contract, or deprived the corporation of its property without due process of law."<sup>152</sup> Waite's reliance on the standard from the Contracts Clause makes the *Sinking Fund Cases* consistent with *Merrion's* statement that unmistakability applies equally to all levels of government.

While I do not mean to suggest that I think the unmistakability standards should be different for the state and federal governments, it is important to understand the arguments for and against similar standards. As argued below, *Winstar* radically altered the unmistakability defense available to the federal government and so these issues will likely arise again later. Because the combination of issues that arise in *Winstar* is so complicated, I hope the reader finds it easier to see these arguments here in simpler form. The argument for maintaining similar standards begins, of course, with the language from the *Sinking Fund Cases* and *Merrion*. These cases treat the unmistakability doctrine as an inherent attribute of sovereignty within the American system of government. The state unmistakability cases treat the doctrine as arising out of the Contracts Clause; if this seems a little inconsistent, the *Merrion* theory leaves plenty of room for the Contracts Clause to govern cases like *Blaisdell*, *Spannaus*, and *Energy Reserves*, which affect purely private contractual rights. As discussed above, having an unmistakability doctrine necessitates separating the private and sovereign actions of the government.

Private contracting parties might prefer similar standards in order to avoid having to entertain two different sets of expectations about the security of their contractual rights against actions by state governments on the one hand and federal government agencies on the other. But this desire for uniformity in expectations is undermined somewhat by the Contracts Clause's exclusive application to the states. The Supreme Court has consistently applied rational basis review and upheld federal laws that trample quite blatantly on private contractual obligations.<sup>153</sup> This deference

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<sup>152</sup> *Id.* at 721-22.

<sup>153</sup> *See, e.g., National Ry. Passenger Corp. v. Atchison, Topeka & Santa Fe R.R.*, 470 U.S. 451 (1985) ("*AMTRAK*") (upholding a federal law changing the rules about how much AMTRAK could charge other railroads for their employees to ride on AMTRAK despite the contractual agreements already in place); *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717 (1984) (finding no violation of due process in requiring a retroactive contribution by an employer to a pension insurance fund upon the employer's withdrawal from the pension plan); *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976) (upholding a federal law

to governmental action is probably more permissive than the Contracts Clause standard under *Spannaus* and *Energy Reserves*.

At this point, it is probably helpful to categorize the various standards that a governmental unit must meet to defend legislation infringing on contractual obligations:

CONSTITUTIONAL STANDARDS TO UPHOLD GOVERNMENTAL  
INFRINGEMENT ON CONTRACT RIGHTS:  
HIGH, MEDIUM OR LOW?

	State Government: Contracts Clause	Federal Government: Due Process Clause
Private Contractual Obligations	Medium standard: Compare <i>Spannaus</i> with <i>Energy Reserves</i>	Low standard: <i>Usery, Mottley, et al.</i>
Regulatory/Govern- mental Obligations	Low standard: <i>Rogers Park, Los Angeles</i> <i>City Water</i>	Low standard: <i>Merrion</i>

Completely uniform standards between state and federal governments would require a moderate revision of the Court's economic due process jurisprudence, at least if the resulting uniform standard were permissive of government interference with contract rights.<sup>154</sup> But the fact that *Blaisdell*

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requiring mining companies to compensate former workers who contracted pneumoconiosis even though miners left the job prior to passage of the law); *Norman v. Baltimore & Ohio R.R.*, 294 U.S. 240 (1935); *United States v. Bankers Trust Co.*, 294 U.S. 240 (1935) (two of the "Gold Clause Cases") (upholding the federal government's move away from the gold standard despite the alleged infringement of obligations in private bonds requiring payment in gold-backed currency); *New York v. United States*, 257 U.S. 591 (1922) (holding that the Contracts Clause does not apply to federal regulations requiring state-chartered railroads to charge more than the maximum allowed in their charter); *Louisville & Nashville R.R. v. Mottley*, 219 U.S. 467 (1911) (holding that a lifetime railroad pass later banned by statute held not enforceable). The Court in *Pension Benefit* specifically rejects the notion that investment-backed expectations need be uniform relative to actions by either state or federal government. *See Pension Benefit*, 467 U.S. at 729.

<sup>154</sup> Moreover, any attempts to impose restrictions on the federal government like those applicable through the Contracts Clause will need to leave room for the federal government's express power to enact bankruptcy laws, which quite expressly infringe the obligation of contracts. *See U.S. CONST. art I, § 8.*

set a higher standard for some time without disastrous consequences for contractual expectations indicates that doctrinal consistency is not much of a necessity, at least as long as any differences in the standards make sense independently. Therefore, there seems to be no strong reason to argue for uniform unmistakability standards between state and federal governments.

There are several reasons why the unmistakability standards, like the standards for private contractual rights, could be different (i.e., reasons other than Stevens' views on tribal sovereignty in *Merrion*). For one, the Supremacy Clause<sup>155</sup> provides that federal laws prevail over contrary state laws. This suggests that the governmental interest could weigh more heavily in the federal unmistakability doctrine than in the state version. Admittedly, it is difficult even to conceive of a lower standard than *Rogers Park* that could still claim to include in its balancing the private parties' rights against the governmental interest. Rather, the upshot of comparing the standards is that, if the standards were to diverge, one would expect the federal standards to be more pro-government than the state standards.<sup>156</sup>

With that in mind, one can now appreciate the difficulties presented by two Depression-era cases that certainly belong in a discussion of the unmistakability doctrine even though neither one mentions or uses it. Indeed, these are the federal analogues to the *Cleveland City Railway* line of cases on the state side. In *Lynch v. United States*,<sup>157</sup> the Court found that Congress violated the Due Process Clause by repealing insurance coverage that was provided earlier for war veterans. Justice Brandeis began the Court's analysis by finding that the insurance policies constituted contracts, supported by separate consideration in the form of monthly premiums.

True, these contracts, unlike others, were not entered into by the United States for a business purpose. . . . But the policies, although not entered into for gain, are legal obligations of the same dignity as other contracts of the United States and possess the same legal incidents.

War risk insurance, while resembling in benevolent purpose pensions, compensation allowances, hospital and other privileges accorded for former members of the army and navy or their dependents, differs from them fundamentally in legal incidents. Pensions, compensation allowances and privileges are gratuities. They involve no agreement of parties;

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<sup>155</sup> See U.S. CONST. art. VI.

<sup>156</sup> This scenario should not offend Madisonian notions of faction either, since the larger federal government, for all its many failings, does seem at least a little less vulnerable to the sort of self-dealing that befell Georgia in the Yazoo land scandal in *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810).

<sup>157</sup> *Lynch v. United States*, 292 U.S. 571 (1934).

and the grant of them creates no vested rights. The benefits conferred by gratuities may be redistributed or withdrawn at any time in the discretion of Congress.<sup>158</sup>

This language depends on the distinction between the business and sovereign roles of the government; here, Brandeis clearly sees the government acting in a business or proprietary capacity.<sup>159</sup> Then, just as the Court did in *Cleveland City Railway*, Brandeis applies the reverse presumption from the traditional unmistakability doctrine: “But no power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress[.]”<sup>160</sup>

Brandeis goes into great depth comparing the government’s obligations in contracting to those of private parties, but the ambiguity of his language unfortunately did little to resolve the threshold issues of when the unmistakability doctrine should apply, or when the government is acting in a sovereign capacity as compared to a business capacity. For example: “When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.”<sup>161</sup> This begs the question of when the “relations” qualify as “contract relations” as opposed to, say, “regulatory relations.” But compare what Brandeis wrote a few pages later:

Contracts between individuals or corporations are impaired within the meaning of the Constitution whenever the right to enforce them by legal process is taken away or materially lessened. *A different rule prevails in respect to contracts of sovereigns.* “The contracts between a Nation and an individual are only binding on the conscience of the sovereign and have no pretensions to compulsive force. They confer no right of action independent of the sovereign will.”<sup>162</sup>

Brandeis resolved the dilemma arising from his logic by distinguishing between the contractual rights created by the government and the legal

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<sup>158</sup> *Id.* at 576-77.

<sup>159</sup> This is consistent with language in the *Sinking Fund Cases*. See *Union Pacific R.R. v. United States and Central Pacific R.R. v. Gallatin*, 99 U.S. 700, 724 (1878) (“The United States occupy towards this Corporation a two-fold relation—that of sovereign and that of creditor.”). Brandeis did not cite this language or case, however.

<sup>160</sup> *Lynch*, 292 U.S. at 578.

<sup>161</sup> *Id.* at 579.

<sup>162</sup> *Id.* at 580-81 (quoting THE FEDERALIST NO. 81 (Alexander Hamilton)) (emphasis added) (citations omitted).

remedies the government makes available to enforce them. Brandeis reasoned that the federal government can never give up the power to reclaim its sovereign immunity,<sup>163</sup> and therefore, Congress could have restricted the pensioners access to federal court to enforce their contracts with the government. But Congress could not simply extinguish the right itself.<sup>164</sup> This is hardly a satisfactory resolution or distinction.<sup>165</sup> As a practical matter, the distinction between right and remedy breaks down at the margin. Moreover, it seems unwise to encourage Congress to drop out of unwanted contracts in such a backhanded way as to restrict access to the courts. Nevertheless, few would argue with the result. By making separate contracts supported by separate consideration, the government tried to act as a private contracting party and should have been held to its contract. But the decision in *Lynch* ultimately did nothing to clarify the threshold issue of when the government should get to use the unmistakability doctrine.

The finding of liability in *Lynch* contrasts with the findings of no liability in the three *Gold Clause Cases* of 1935.<sup>166</sup> These cases arose after Congress stripped the nation's currency of its backing in gold, doing away with the gold dollars that had traditionally been the nation's hard currency. Though the legislation tried to maintain a loose connection between the value of the dollar and gold (by committing to stable foreign exchange rates based on gold), it also banned private ownership of gold, effectively making money itself the store of value, whereas before, money's value was understood to derive from the supposedly intrinsic value of the metal. Prior to this time, contracting parties often differentiated between payment in dollars and payment in gold. Countless thousands of these so-called "gold clauses" were thrown into doubt by this legislation, in a more fundamental way than earlier changes in the currency.<sup>167</sup> The three *Gold Clause Cases*

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<sup>163</sup> See *id.* at 581 ("The rule that the United States may not be sued without its consent is all embracing.").

<sup>164</sup> See *id.* at 581-83.

<sup>165</sup> Cf. Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 679-80 (arguing that *Lynch* can be read to mean that government can not repudiate its own debts "simply in order to save money," but can for "collateral public policies"). Professor Schwartz's argument seems like a version of the sovereign acts doctrine under which broad legislation that incidentally infringes on relatively few contracts is sustained. See *infra* Part II.A. But see Harold J. Krent, *Reconceptualizing Sovereign Immunity*, 45 VAND. L. REV. 1529, 1576 (1992) (arguing that the repeal of insurance "affected only several hundred policy holders").

<sup>166</sup> See *supra* note 153.

<sup>167</sup> For example, during the Civil War, the government issued "greenback" currency which was not backed at all by gold and which consequently suffered

all refused to award damages against the government, in three representative fact patterns. *Norman v. Baltimore & Ohio Railroad*,<sup>168</sup> involved gold clauses in private contracts, specifically the private bonds of the Baltimore & Ohio Railroad. *Nortz v. United States*<sup>169</sup> involved gold certificates that the government issued attesting that certain quantities of gold were set aside for the beneficiary of the certificate. *Perry v. United States*<sup>170</sup> involved Treasury bonds payable in gold dollars according to the gold clauses in the bonds. Even though all three cases were decided by the same 5-4 vote, *Perry* stands as the most controversial.

In *Norman*, the government essentially admitted that the legislation devalued the old, gold-backed currency, but countered that everyone now held the same currency. For example, the government argued that, "It would be impractical to eliminate the gold clause from future issues only, since investors would prefer the old issues, public or private, to such an extent as to require prohibitive rates on the new."<sup>171</sup> The Court analyzed the case as a conflict between private contractual rights and the federal government's power under the Commerce Clause and reasoned that the federal power simply overcomes these contractual rights: "Contracts, however express, cannot fetter the constitutional authority of the Congress. . . . Parties cannot remove their transactions from the reach of dominant constitutional authority by making contracts about them."<sup>172</sup> *Norman* is the federal analogue to *Blaisdell* and, consistent with *Mottley* and *Usery*, stands for the supremacy of the Commerce Clause power over private contractual rights. Professor Schwartz argues convincingly that the gold clause cases are better understood as examples of the sovereign acts doctrine working to shield the government from liability.<sup>173</sup> This makes a

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from inflationary tendencies. See, e.g., *Gregory v. Morris*, 96 U.S. 619 (1878) (upholding a lower court judgment payable in gold bullion); *Trebilcock v. Wilson*, 79 U.S. (12 Wall.) 687 (1871) (holding that when a contract for money is by its terms made payable in specie or in coin, judgment payable in coined dollars is appropriate); *Knox v. Lee*, 79 U.S. (12 Wall.) 457 (1870) (holding the Legal Tender Acts constitutional as applied to contracts made both before and after their enactment); *Bronson v. Rodes*, 74 U.S. (7 Wall.) 229, 251 (1868) (holding that payment in greenbacks in 1865 for debt arising from a 1861 contract which called for gold coin is not sufficient—gold coin is required).

<sup>168</sup> *Norman v. Baltimore & Ohio R.R.*, 294 U.S. 240 (1935).

<sup>169</sup> *Nortz v. United States*, 294 U.S. 317 (1935).

<sup>170</sup> *Perry v. United States*, 294 U.S. 330 (1935).

<sup>171</sup> *Norman*, 294 U.S. at 275.

<sup>172</sup> *Id.* at 307-08.

<sup>173</sup> See Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 680-82.

great deal of sense because the government relied on the fact that devaluation affected everyone equally as its defense. The sovereign acts doctrine provides a defense for the government when the breaching legislation has “public and general” effects well beyond simply breaching plaintiffs’s contracts.<sup>174</sup>

In *Nortz*, the plaintiffs argued that the government acted in its “corporate or proprietary capacity” in issuing the gold certificates.<sup>175</sup> The Court found that the certificates were not contracts,<sup>176</sup> but then relied on a technical flaw in the facts supporting plaintiff’s claims. Plaintiffs first demanded the gold on January 17, 1934, yet by this time the new legislation already prohibited plaintiffs from possessing gold. The devaluation did not occur until two weeks later on January 30, 1934, so the dollars disbursed on January 17, 1934 were not yet devalued.<sup>177</sup> This reasoning, by itself, might have left open the possibility that another plaintiff who waited to withdraw his gold might do better in litigation, but the combined holdings of *Norman* and *Perry* squashed that hope.

In *Perry*, the contracts at issue were bonds issued by the Treasury. Writing for the majority, Justice Hughes distinguished between two powers of the government:

There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority [i.e., *Norman*], and the power of Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers.<sup>178</sup>

This distinction is not exactly the same as the sovereign/business role distinction. Under Hughes’ distinction, the government will be bound whenever it borrows money “on the credit of the United States.”<sup>179</sup> This follows from Hughes’ interpretation of the word “credit”: “[t]he binding quality of the promise of the United States is of the essence of credit which is so pledged.”<sup>180</sup> The gold clauses in the government bonds therefore

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<sup>174</sup> See *Horowitz v. United States*, 267 U.S. 458, 461 (1925).

<sup>175</sup> See *Nortz*, 294 U.S. at 318.

<sup>176</sup> See *id.* at 326.

<sup>177</sup> See *id.* at 328-29.

<sup>178</sup> *Perry v. United States*, 294 U.S. 330, 350-51 (1935).

<sup>179</sup> *Id.* at 351 (quoting U.S. CONST. art I, § 8, cl. 2).

<sup>180</sup> *Id.* at 353.



bound the government, and the currency legislation breached the government's obligations.

*Perry* clearly sets forth a rule that when the federal government borrows money, it will be bound just as if it were a private contracting party.<sup>181</sup> But, as with the other cases discussed herein, the opinion does not articulate a broader rule for distinguishing generally when the government will be treated as a private party and when it may use special governmental defenses. Congress has the power to "control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority[.]"<sup>182</sup> But, the government should not escape liability simply because it exercises "constitutional authority," as this would be a wildly underinclusive rule. For example, if the government contracted to buy boots for the army, promised to pay cash, and later breached the contract due to subsequent legislation enacted pursuant to constitutional power, no borrowing on the government's "credit" is involved, but we would expect the government to be bound just as if it were a private party. *Perry* includes its own rendition of the question-begging language that runs through many of these cases: "When the United States, with constitutional authority, *makes contracts*, it has rights and incurs responsibilities similar to those of individuals[.]"<sup>183</sup> In light of what we know from the unmistakability doctrine cases, we are left to wonder when the government makes "contracts" and when it makes other kinds of agreements that enable it to use its special contract defenses.

Despite the finding of breach in *Perry*, the government nevertheless escaped from paying damages because the Court found that plaintiffs could not prove any damages. The legislation's universal effect on all actors in the domestic economy made it impossible for plaintiffs to come up with a factual comparison that showed how they were worse off than others. Since the "free domestic market for gold was nonexistent," plaintiff could not establish "that in relation to *buying power* he has sustained any loss whatever."<sup>184</sup> The Court implicitly recognized the relative value of money

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<sup>181</sup> *See id.* at 352.

<sup>182</sup> *Id.* at 350.

<sup>183</sup> *Id.* at 352 (emphasis added). The Court cited the *Sinking Fund Cases* and *Lynch*. Compare this language to that from *Lynch*: "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Lynch v. United States*, 292 U.S. 571, 579 (1934).

<sup>184</sup> *Perry*, 294 U.S. at 357 (emphasis added). At the time of breach, [a] free domestic market for gold was non-existent. . . . That equivalence or worth [necessary for proving damages] could not properly be ascertained

and reasoned that since all money had been equally devalued, everyone ended up with the same buying power.<sup>185</sup> Access to the international market does not undermine this logic because the legislation first made it illegal to possess gold, shutting off the plaintiff's effective access to the overseas gold markets. The Court's reliance on the universality of the effects strongly supports Professor Schwartz's interpretation that *Perry* is better understood as an example of the sovereign acts doctrine.<sup>186</sup>

Neither the *Gold Clause Cases* nor *Lynch* explain why the unmistakability doctrine does not apply. These decisions ultimately reflect the same failure of the case law to establish a general rule for determining when the government may assert the unmistakability doctrine and when it may not. As I argue in Part II, much more sense can be made out of the distinction between the government's sovereign versus proprietary roles, and the decisions in *Lynch* and the *Gold Clause Cases* are consistent with this general theory. Consistent with this distinction is the Court's decision to issue separate opinions and reasonings for *Norman*, where the bonds were privately issued, and *Perry*, where the bonds were issued by the government. But for the present purpose of understanding the *Winstar* decision, the more important point is the lingering ambiguity in the threshold issue of when the unmistakability doctrine applies.

Another manifestation of this ambiguity is the differing views over how broadly the Court's inquiry should range. In *Norman*, the Attorney General thought the issues are broad: "Those who insist upon the strict letter of the bond are insisting upon it in a matter dealing with gold, and gold lies at the basis of our financial structure. Gold is the subject of national legislation. . . . Gold is affected with the public interest."<sup>187</sup> In viewing the issue as whether the government acted according to its constitutional powers, the government wanted to include in its analysis the broader context supporting the rationality of the legislation and its interpretation of the Constitution. By contrast, plaintiffs viewed the issue as a contract dispute and wanted the Court to limit its inquiry to recon-

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save in the light of the domestic and restricted market which the Congress had lawfully established. In the domestic transactions to which the plaintiff was limited, in the absence of special license, determination of the value of the gold coin would necessarily have regard to its use as legal tender and as a medium of exchange under a single monetary system with an established parity of all currency and coins.

*Id.*

<sup>185</sup> See *id.* at 358.

<sup>186</sup> See Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 682.

<sup>187</sup> *Norman v. Baltimore & Ohio Ry.*, 294 U.S. 240, 257 (1935).

structuring the intent of the contracting parties. As with the threshold issue of whether the unmistakability defense applies, the two sides of this issue seem to talk past one another.

In sum, the federal cases illustrate the same three themes as the state unmistakability cases. First, the strongest examples of the unmistakability doctrine's interpretive presumption appear in *Rogers Park* for the state side and *Merrion* for the federal side. In both cases, the government agreed to a certain rate structure and made no additional express promise that it would not later exercise its sovereign power to change those rates. The Court read that silence as being ambiguous and then held in favor of the government. Second, there are parallel examples, where the Court held the government liable: *Cleveland City Railway* on the state side and *Lynch* on the federal side. These parallel lines of cases do not mention unmistakability nor offer a general explanation of why the unmistakability defense does not apply. Third, the Court has established different tests for upholding government infringement on contract rights in cases like *Spannaus* and *Energy Reserves*, where the state infringes on contracts between private parties, and *Mottley* where the federal government does the same thing. The resulting two-by-two grid of liability standards results in moderate definitional pressure to clarify when each standard applies, especially in two specific examples. To keep clear whether *Spannaus* and *Energy Reserves* controls, or if *Rogers Park* applies, it would seem important to distinguish when the government is acting in a sovereign capacity from when its contracts are treated as private contracts.<sup>188</sup> Although it is unclear whether the unmistakability defense should operate equally for the states as for the federal government, it seems clear that if the defenses differ, the federal government should benefit from a stronger version.

## 2. *The Government's Reputation as Contracting Partner*

Several of the cases discussed above that adopted a congruence approach and which did not mention the unmistakability doctrine reasoned that the government's contracts must be enforced just as private contracts in order to protect the government's reputation as a contracting partner.<sup>189</sup> Without a dependable reputation, the government would need to pay more or offer more concessions to get the same things and this would, ultimately, cost the taxpayers more than it should. A typical example comes from *Lynch*: "Punctilious fulfilment of contractual obligations is essential to the

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<sup>188</sup> This is the same question raised by the threshold issue.

<sup>189</sup> See, e.g., *Detroit v. Detroit Citizens' St. Ry.*, 184 U.S. 368 (1902).

maintenance of the credit of public as well as private creditors.”<sup>190</sup> The Court went further in *Perry* and found that Congress’ constitutional authority to “borrow money on the credit of the United States”<sup>191</sup> necessarily means that the United States must honor all its debts.

But the nation’s credit reputation is somewhat self-policing in that any Congress that reneges on government obligations, to the extent that the government’s credit rating suffers, will certainly risk a powerful political backlash. One need only recall the budgetary game of chicken played recently by congressional Republicans and President Clinton to see the political check in action. As a textual matter, “credit of the United States” need not imply a perfect credit rating.<sup>192</sup> Moreover, some sort of escape valve is probably wiser policy, if the threshold is set high enough. Indeed, this may be the best reading of *Charles River Bridge*. In that case, the bridge proprietors who obtained the franchise at issue, and their financial backers, were certainly long since dead when the state chartered the competing bridge.<sup>193</sup> Given that several generations had passed and that Boston residents paid a steep price in tolls and inconvenience to the successors-in-interest of the charter,<sup>194</sup> it had to be a close call as to whether the state minimized its costs to its taxpayers by chartering a new bridge and risking a higher premium on its credit. The public policy advantages in breaching the agreement so overwhelmingly outweighed the risk of harm to the state’s reputation as a contracting partner. The lesson to future contractors is not beware of contracting with the state, but rather, don’t count on bargains that make you and several generations of your assignees unreasonably wealthy.

This issue is closely related to the one of how best to represent the will of the people when the current will clashes with the will of a prior generation. *Perry* ignores this completely and simply presumes that the prior generation controls: “The Congress as the instrumentality of sovereignty is endowed with certain powers to be exerted on behalf of the people in the manner and with the effect the Constitution ordains. The Congress cannot invoke the sovereign power of the people to override their

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<sup>190</sup> *Lynch v. United States*, 292 U.S. 571, 580 (1934).

<sup>191</sup> U.S. CONST. art. I, § 8, cl. 2.

<sup>192</sup> Early Supreme Court decisions affirming the states’ debts went a long way to stabilizing the country and were undoubtedly the correct outcomes at the time. *See, e.g., Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810).

<sup>193</sup> *See Charles River Bridge Co. v. Warren Bridge Co.*, 36 U.S. (11 Pet.) 420, 537-38 (1837).

<sup>194</sup> *See id.* at 456 and 491.

will as thus declared.”<sup>195</sup> Similarly, in *Fletcher v. Peck*,<sup>196</sup> the Court reasoned that:

[T]he framers of the [C]onstitution viewed, with some apprehension, the violent acts which might grow out of the feelings of the moment; and the people of the United States, in adopting that instrument, have manifested a determination to shield themselves and their property from the effects of those sudden and strong passions to which men are exposed.<sup>197</sup>

This reasoning begs the question as to which legislature is affected by the “sudden and strong passions” and which is guided by sounder, more sober judgment. A priori, the second legislature probably has more time and more information, including about any effects on the sovereign’s credit rating from any previous repudiations, with which to reach a decision. Moreover, at the time of *Fletcher*, the young government was, for good reason, much more concerned with developing a strong reputation as a contracting partner. Now that the government has established just such a strong reputation, the question is no longer whether the government may ever break its regulatory agreements, but rather, what circumstances and legal standards should govern. Surely the standard must be set high in cases involving the government acting in a private capacity, as it did in *Fletcher* and *Perry*.

In this light, one can see how the often-quoted language in *United States v. Bekins*,<sup>198</sup> does little to clarify the issue. In *Bekins*, the Supreme Court upheld a federal bankruptcy law that authorized municipal taxing districts to reorganize even though the reorganization necessarily involved direct infringement on the contract rights of the municipality’s creditors. In language cited by Souter in *Winstar*, the Court reasoned:

It is of the essence of sovereignty to be able to make contracts and give consents bearing upon the exertion of governmental power. This is constantly illustrated in treaties and conventions in the international field by which governments yield their freedom of action in particular matters in order to gain the benefits which accrue from international accord.<sup>199</sup>

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<sup>195</sup> *Perry v. United States*, 294 U.S. 330, 353 (1935).

<sup>196</sup> *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810).

<sup>197</sup> *Id.* at 137-38.

<sup>198</sup> *United States v. Bekins*, 304 U.S. 27 (1938).

<sup>199</sup> *Id.* at 51-52.

The Court then listed two more examples of government “contracting”: states making “compacts” with each other and states contracting with individuals.<sup>200</sup> In the first two examples, the contracting parties relate to each other as legal equals. Their agreement is the only basis for enforcement of the contract against the other. The last example, however, offers an ambiguous situation because the state has sovereign, regulatory power over individuals, but it can also enter into a contract with individuals, for example by hiring them. In the situations where the government contracts with legal equals, such as employees it hires, its reputation as a contracting partner is clearly very important. Individuals entering into subsequent contracts have full freedom to extract a premium for the government’s poor reputation.<sup>201</sup> But when the government reaches a regulatory agreement with someone directly regulated, the concern with protecting the government’s reputation as a contracting partner amounts to a concern that the government will either not change its regulation or will bargain for the right to do so. The strength of the unmistakability doctrine is that it retains for the government the right to act as a sovereign, without having to seek permission to change course or purchase the right. Without mentioning any of the limitations of the *Bekins* language, Justice Souter cites the quoted language for the proposition that all government agreements, including regulatory agreements, are treated as private contracts: “[T]he Government’s practical capacity to make contracts [is] . . . ‘of the essence of sovereignty’ itself.”<sup>202</sup> Sovereignty, in fact, is better understood as the antithesis of contracting. The distinction between the sovereign and

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<sup>200</sup> See *id.* at 52.

<sup>201</sup> One wonders, for example, whether the Federal Reserve System will suffer a damaged reputation as a contracting partner for successfully claiming sovereign immunity from contract claims, even where it entered into the government contract in its private capacity. See *Research Triangle Institute v. Board of Gov. of the Fed. Reserve Sys.*, 132 F.3d 985 (4th Cir. 1997), *cert. denied*, 119 S. Ct. 44 (1998) (finding that the Tucker Act did not apply to the Federal Reserve Board, so background sovereign immunity applied against a contract claim brought by a research institute hired by the Federal Reserve Board to collect data about small business use of financial services). The contract at issue in *Research Triangle Institute* did not involve the Federal Reserve Board’s regulatory authority, if any, over Research Triangle Institute. There seems little to stop the Federal Reserve Board from raising its win in *Research Triangle Institute* as a defense to paying any contract claim in the future, at least in the Fourth Circuit.

<sup>202</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 884 (1996) (quoting *Bekins*, 304 U.S. at 51-52).

proprietary roles of the government is discussed more fully in Part II below. For now, the key point is that although the government's reputation as a contracting partner needs protection, this need does not conflict with the unmistakability doctrine.

### 3. *The Unmistakability Doctrine Should Have Given Mixed Results in Winstar*

This section applies the unmistakability doctrine, as understood by *Rogers Park* and *Merrion*, to the facts of *Winstar* and concludes that the Court in *Winstar* reached the correct conclusion for only one of the three plaintiffs. The analysis here is limited to my application of the unmistakability doctrine to the relevant agreements; the next sections criticize *Winstar*'s reasoning in detail.<sup>203</sup> To apply this defense, one must analyze the language of the agreements entered into by the governmental agency and the thrifts.

The first of the three plaintiff thrifts in *Winstar*, Glendale Federal Bank, FSB ("Glendale"), entered into a "Supervisory Action Agreement" with the FHLBB in 1981 in order to acquire an insolvent thrift and secure goodwill capital from the Bank Board.<sup>204</sup> The Supervisory Action Agreement incorporated "the Agreement of Merger and any resolutions or letters issued contemporaneously herewith," which included "a stipulation that any goodwill arising from this transaction shall be determined and amortized in accordance with [Bank Board] Memorandum R 31b," which permitted goodwill under the purchase method of accounting and amortization thereof.<sup>205</sup>

Because there is no language in the Supervisory Action Agreement that in any way discusses the FHLBB's authority to regulate capital accounting, the agreements should be read as silent on the issue of government power. Therefore, nothing should overcome the unmistakability doctrine's presumption that the FHLBB retains all its regulatory power over Glendale.

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<sup>203</sup> See discussion *infra* Parts I.D. and E. I assume that the unmistakability defense applies because the nature of the government's regulatory role appears much more in line with the unmistakability cases, such as the water utility cases, than cases like *Lynch*. My full argument appears in Part II; to put that argument here, before discussing *Winstar*, would run the risk of improperly implying that *Winstar* simply *misread* the unmistakability doctrine. Instead, I argue later in Part I that *Winstar* took advantage of ambiguities in the unmistakability case law and that its interpretation poorly serves our administrative system of government.

<sup>204</sup> See *Winstar*, 518 U.S. at 861.

<sup>205</sup> See *id.* at 862.

Justice Souter, writing the lead opinion for a plurality of the Court in *Winstar*, denied the government the protection of the unmistakability defense against the Glendale plaintiffs.<sup>206</sup>

The second plaintiff, The Statesman Group, Inc. ("Statesman"), acquired an insolvent Florida thrift and three weak Iowa thrifts in 1988. Regulatory agreements provided for substantial cash infusions into the thrifts from Statesman and the FSLIC as well as supervisory goodwill and a commitment by Statesman to infuse additional capital if the thrifts fell below regulatory capital minimums.<sup>207</sup> The provision governing goodwill stated: "For purposes of this Agreement, any determination of [Statesman's] Required Regulatory Capital . . . shall include . . . amounts permitted by the FSLIC in the Assistance Agreement and in the forbearances issued in connection with the transactions discussed herein."<sup>208</sup> Statesman also agreed to "comply in all material respects with all applicable statutes, regulations, orders of, and restrictions imposed by the United States or . . . by any agency of [the United States]."<sup>209</sup> Similar to the Glendale agreement, the Statesman agreement with the FHLBB included no unmistakable promise not to change the regulatory treatment of the new thrift. Furthermore, Statesman's agreement to comply with all applicable regulations seemed to reserve the FHLBB's the authority to change its regulations. Again, however, Souter's opinion denied the government its defense of the unmistakability doctrine with respect to Statesman.<sup>210</sup>

The third plaintiff, Winstar Corporation ("Winstar"), had a stronger case. Winstar sought to take over Windom Federal S&L, a weak thrift in Minnesota. Like the other plaintiffs, Winstar entered into several agreements with the FHLBB. Goodwill capital was provided for in an "Assistance Agreement," which incorporated a forbearance letter issued on same date as the Bank Board resolution approving the merger.<sup>211</sup> The forbearance letter provided for recognition of goodwill: "For purposes of reporting to the Board, the value of any intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by [Winstar] over a period not to exceed 35 years by the straight-line method."<sup>212</sup> The Assistance Agreement provided that generally accepted

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<sup>206</sup> *See id.* at 887.

<sup>207</sup> *See id.* at 866-67.

<sup>208</sup> *Id.* at 867.

<sup>209</sup> *Id.* at 868.

<sup>210</sup> *See id.* at 887.

<sup>211</sup> *See id.* at 864.

<sup>212</sup> *Id.* at 864-65.



accounting principles would control the accounting practices of the new thrift, except where contradicted by Bank Board regulations or by the Assistance Agreement: "If there is a conflict between such regulations and the Bank Board's resolution or action, *the Bank Board's resolution or action shall govern.*"<sup>213</sup> This last provision can only mean that if the Bank Board attempted to change its regulation of goodwill by adopting new regulations requiring a different accounting treatment, the new regulations would not apply to Winstar. Although this last provision does not use the same style of language as that from *Los Angeles v. Los Angeles City Water Co.*,<sup>214</sup> the meaning seems *unescapably* clear, and this ought to overcome the presumption from the unmistakability doctrine. In sum, the traditional unmistakability doctrine probably should have protected the government from contract liability in the cases of Glendale and Statesman, but not Winstar.

#### 4. Winstar *All But Erases the Unmistakability Doctrine*

##### a. Souter Lets the Plaintiffs Avoid the Unmistakability Doctrine

Writing for the plurality, Justice Souter refused to apply the unmistakability doctrine to the agreements entered into by the thrifts and the regulatory agencies.<sup>215</sup> Instead, Souter affirmed the holding of the en banc Federal Circuit panel, which found that the unmistakability doctrine should not apply where the plaintiffs seek damages because damage awards do not completely block the government's ability to enact new laws.<sup>216</sup> The lower court reasoned that the unmistakability doctrine aims to balance the government's powers to legislate with the interests of private parties who rely on government promises; since the government can pass new laws and pay damages at the same time, there is no need for the unmistakability doctrine where plaintiffs do not seek an injunction against application of the new law to them. Only an injunction would actually limit the government's sovereign power.<sup>217</sup> Souter refined this reasoning by adding the proviso that a damages claim could be effectively equivalent to an injunction<sup>218</sup> if, for example, the new law revoked a promise not to levy a

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<sup>213</sup> *Id.* at 865 (emphasis added).

<sup>214</sup> *Los Angeles v. Los Angeles City Water Co.*, 177 U.S. 558, 560 (1900) ([The city] "shall not so reduce such water rates . . . less than those now charged.").

<sup>215</sup> See *Winstar*, 518 U.S. at 887.

<sup>216</sup> See *Winstar v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (en banc).

<sup>217</sup> See *id.* at 1547-48.

<sup>218</sup> See *Winstar*, 518 U.S. at 878-80.

certain tax. In such a case, the damages award for paying the tax and injunction against the tax amount to the same thing, and therefore, the government could raise the unmistakability doctrine under Souter's new rule. In the absence of the unmistakability doctrine, Souter applies what he describes as the "traditional" method of construing contracts.<sup>219</sup>

This section criticizes Souter's dismissal of the unmistakability doctrine as a radical revision of the doctrine, even considering its ambiguities. Although Souter's logic is not flatly contradicted by any specific holdings, this is a product of the failure of the cases to articulate rules to resolve the ambiguities discussed above and the relative paucity of cases on the federal side. Souter's rule is impossible to reconcile with the state unmistakability cases because he reduces the doctrine almost to the vanishing point. From the perspective of pure logic, Souter's rule, while somewhat convoluted, does avoid self-contradiction, but one should question the broader wisdom of eliminating this important doctrine.

Souter begins his analysis of the unmistakability doctrine with a straight-forward historical summary of the doctrine's origins. "This doctrine marks the point of intersection between two fundamental constitutional concepts, the one traceable to the theory of parliamentary sovereignty made familiar by Blackstone, the other to the theory that legislative power may be limited[.]"<sup>220</sup> That legislative power is limited by constitutional guarantees, such as the Contracts Clause, is sometimes called the American rule in this context, and Souter properly describes *Fletcher v. Peck*<sup>221</sup> as the first major example of the American rule.<sup>222</sup> *Fletcher* arose out of the Yazoo land scandal in Georgia. The state legislature sold off most of what became Mississippi and Alabama at fire sale prices to a few landholding companies in New England.<sup>223</sup> "All but one member of the Georgia legislature personally profited from the deal, and several made substantial fortunes."<sup>224</sup> The next year, after the scandal had swept the 1795 legislators out of office, the newly elected legislature promptly rescinded the sales in an attempt to reclaim the land for the state.<sup>225</sup> The landowners,

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<sup>219</sup> See *id.* at 904.

<sup>220</sup> *Id.* at 872.

<sup>221</sup> *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810).

<sup>222</sup> See *Winstar*, 518 U.S. at 873.

<sup>223</sup> See JEAN EDWARD SMITH, JOHN MARSHALL: DEFINER OF A NATION 388 (1996).

<sup>224</sup> *Id.* at 388-89.

<sup>225</sup> See *id.* at 389.

who, by now, were not the original purchasers,<sup>226</sup> sued and eventually prevailed in the famous decision by Chief Justice John Marshall. Marshall reasoned that the 1796 legislation violated the Contracts Clause of the Constitution because it attempted to undo the 1795 contracts of sale, and this was akin to rolling back time: “if an act be done under a law, a succeeding legislature cannot undo it.”<sup>227</sup> It made no difference that the contracts of sale were “executed” contracts, because: “[a] contract executed, as well as one which is executory, contains obligations binding on the parties.”<sup>228</sup> Justice Johnson, in concurrence, preferred a natural law basis over the Contracts Clause. He strongly suggested that the government should owe at least some compensation to the new landowners affected by the legislation reclaiming the land for the state.<sup>229</sup> Johnson’s suggestion of a takings remedy<sup>230</sup> gives an important clue as to why Marshall may have felt it desirable to stretch the Contracts Clause to reach “contracts executed”; it was the only constitutional basis for invalidating the 1796 legislation, since the Due Process Clause had not yet been incorporated against the states.<sup>231</sup> In light of the subsequent incorporation of the entire Bill of Rights against the states, the precise holding of *Fletcher* could stand some significant limitation with respect to “contracts executed” without sacrificing any protection for private property.

Souter makes no mention of this, but for our purposes the more important point is that he is careful to explain that Marshall saw two distinct limitations on the sovereignty of the 1796 Georgia legislature. According to Souter, Marshall based his conclusions on “the two distinct reasons that the intrusion on vested rights by the Georgia Legislature’s Act of repeal might well have gone beyond the limits of ‘the legislative power,’

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<sup>226</sup> *See id.* at 389-90.

<sup>227</sup> *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 135 (1810). Professor Griffith points out that Marshall never really “reconciled the tension between this principle [i.e., that one legislature cannot bind the next] and the contract clause.” Griffith, *supra* note 43, at 289.

<sup>228</sup> *Fletcher*, 10 U.S. (6 Cranch) at 137.

<sup>229</sup> *See id.* at 143-48 (Johnson, J., concurring).

<sup>230</sup> *See id.* at 145 (Johnson, J., concurring).

<sup>231</sup> Compare *Barron v. Baltimore*, 32 U.S. (7 Pet.) 243 (1833) (rejecting incorporation of the Bill of Rights against the states); *with Twining v. New Jersey*, 211 U.S. 78 (1908), *overruled in part by Malloy v. Hogan*, 378 U.S. 1 (1964) (applying principles from the Due Process Clause); *and Palko v. Connecticut*, 302 U.S. 319 (1937) (incorporating the Due Process Clause against the states). This probably explains Johnson’s reluctance to argue more directly for a takings remedy as well.

and that Georgia's legislative sovereignty was limited by the Federal Constitution's bar against laws impairing the obligation of contracts.<sup>232</sup> The first basis is the American rule of limited sovereignty. Thus, Souter reads *Fletcher* as reflecting an inherent limitation on sovereignty, which came to support the unmistakability doctrine. In addition, *Fletcher* and the unmistakability doctrine drew support from the Contracts Clause of the Constitution. There seems to be no need to extract out of general principles of sovereignty the very same rule that appears in the Contracts Clause, except to imply that the limitation in the Contracts Clause is also fundamental to all forms of sovereign power in America, including the federal government, even though the Contracts Clause by its terms only applies to the states. This is why the unmistakability doctrine applies to the federal government.

Souter explains that the unmistakability doctrine, as well as the reserved powers doctrine, grew out of the need to balance the conflicting goals of protecting sovereign power and contractual rights. He cites without comment *Providence Bank v. Billings* and *Charles River Bridge*.<sup>233</sup> Souter then briefly quotes two landmark unmistakability cases, but does not discuss the ambiguity they take on following his view that damages do not limit sovereign power.<sup>234</sup> From *Minot v. Philadelphia & Baltimore Railroad*,<sup>235</sup> Souter quotes: "All public grants are strictly construed. Nothing can be taken against the state by presumption of inference."<sup>236</sup> This wording of the rule would seem to require a strict construction against all governmental promises, including promises to pay damages, because it is apparently to be applied as the first step in construing the agreement. As an interpretive tool, strict construction is used to discover what promises the government made, without any reference to the type of liability to be imposed for breach of those promises.<sup>237</sup> But then, from *Jefferson Branch Bank v. Skelly*,<sup>238</sup> Souter quotes: "neither the right of taxation, nor any other

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<sup>232</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 873-74 (1996).

<sup>233</sup> *See id.* at 874.

<sup>234</sup> *See id.*

<sup>235</sup> *Minot v. Philadelphia & Baltimore R.R.*, 85 U.S. (18 Wall.) 206 (1873).

<sup>236</sup> *Winstar*, 518 U.S. at 874 (quoting *Minot*, 85 U.S. (18 Wall.) at 225). Souter quoted the sentences separately.

<sup>237</sup> At least one commentator uses "strict construction" as a synonym for unmistakability. *See, e.g., Mitchell, The Treatment of Public Contracts, supra* note 65, at 196.

<sup>238</sup> *Jefferson Branch Bank v. Skelly*, 66 U.S. (1 Black) 436 (1861) (finding a violation of the Contracts Clause).

power of sovereignty, will be held . . . to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken.”<sup>239</sup> This passage arguably supports the same strict construction rule as the first quote. But by speaking more directly in terms of “power” and “surrender” of the power, the *Skelly* quote also supports Souter’s reading that the unmistakability doctrine is only concerned with protecting the sovereign power to make new laws, and that damages might therefore be of less concern. However, Souter does not mention this ambiguity in the quotes or in the cases making up the unmistakability doctrine.

Instead, Souter asserts: “The posture of the Government in these early unmistakability cases is important. . . . In each case, the private party was suing to invalidate the abrogating legislation under the Contracts Clause.”<sup>240</sup> This is correct, but incomplete. First, the plaintiffs in *Charles River Bridge* and *Chenango Bridge* sought both an injunction and damages, but in neither case did the Court differentiate the claims on the basis of the effect the relief would have on the state’s sovereign power.<sup>241</sup>

Moreover, few states at the time had waived their sovereign immunity against damages for contract actions, and it does not appear that Massachusetts or New York were among the early few.<sup>242</sup> If, as seems likely, Massachusetts and New York had not waived sovereign immunity against contract claims, then the only basis for suit would have been the Contracts Clause, which does not provide for damages.<sup>243</sup> It therefore

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<sup>239</sup> *Winstar*, 518 U.S. at 874-75 (quoting *Jefferson Branch*, 66 U.S. (1 Black) at 446).

<sup>240</sup> *Id.* at 875.

<sup>241</sup> See *Charles River Bridge Co. v. Warren Bridge Co.*, 36 U.S. (11 Pet.) 420, 427-28 (1837); *Chenango Bridge Co. v. Binghamton Bridge Co.*, 70 U.S. (3 Wall.) 51, 72 (1865).

<sup>242</sup> Massachusetts law permits contract claims against the commonwealth, see MASS. GEN. LAWS ch. 258, § 12 (1992), but this provision was enacted in 1979. Cf. *Mower v. Leicester*, 9 Mass. 247 (1812) (recognizing the sovereign immunity defense). New York’s current waiver of sovereign immunity was enacted in 1920. See N.Y. CT. CL. Act art. II, § 8 (McKinney 1989). See also Enrico G. Gonzalez, Note, *Contract Law/Sovereign Immunity—the Demise of Sovereign Immunity in the Contractual Battle Against State Agencies—Champagne-Webber, Inc. v. Fort Lauderdale*, 519 So. 2d 696 (Fla. Dist. Ct. App. 1988), 17 FLA. ST. U. L. REV. 899, 904 (1990) (mentioning states’ efforts to restrict their sovereign immunity); Renna Rhodes, *Principles of Governmental Immunity in Texas: The Texas Government Waives Sovereign Immunity When it Contracts—or Does It?*, 27 ST. MARY’S L.J. 679, 681-82 (1996) (same). The federal government did not do so until 1898 with the passage of the Tucker Act.

<sup>243</sup> See U.S. CONST. art. I, § 10, cl. 1.

makes little sense to distinguish these cases on the basis of the remedy at issue.

Souter appears to consider the state unmistakability doctrine cases as somehow informative but not controlling. Souter goes on to acknowledge that it is unclear how much the unmistakability doctrine case law should be read to apply to the federal government: "Although the Contracts Clause has no application to acts of the United States, it is clear that the National Government has some capacity to make agreements binding future Congresses by creating vested rights. The extent of that capacity, to be sure, remains somewhat obscure."<sup>244</sup> Souter then discusses in some detail the three federal unmistakability cases analyzed above—*Merrion*, *POSSE*, and *Cherokee Nation*. He does not similarly summarize any state cases, other than *Fletcher*, in his introductory paragraphs. This murky status of the state cases reflects a potential dilemma for Souter; if the state cases applied to the federal government, for example, because the unmistakability doctrine arises from inherent principles of sovereignty and so applies to all levels of government, then the plurality opinion contradicts the holdings of *Charles River Bridge* and *Binghamton Bridge* and ignores the analysis of the *Rogers Park* line of cases.<sup>245</sup> If the state unmistakability doctrine cases do not apply, for example because they are grounded in the Contracts Clause, then *Winstar* has made it much more difficult for the federal government, relative to the states, to escape contract liability for regulatory agreements.

Souter does not address this internal tension in his reasoning, but instead moves on to summarize his unmistakability rule:

*Merrion*, *Bowen* [i.e., *POSSE*], and *Cherokee Nation* thus announce no new rule distinct from the canon construction adopted in *Providence Bank* and *Charles River Bridge*; their collective holding is that a contract with a sovereign government will not be read to include an unstated term exempting the other contracting party from the application of a subsequent sovereign act (including an Act of Congress), nor will an ambiguous term of a grant or contract be construed as a conveyance or surrender of sovereign power[.]<sup>246</sup>

This phrasing of the rule focuses on the government's subsequent use of power, not on the presence or absence, in the initial agreement, of any

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<sup>244</sup> *Winstar*, 518 U.S. at 875-76 (citations omitted).

<sup>245</sup> *Cf. id.* at 919 (Scalia, J., concurring) (contending that the plurality's treatment of unmistakability doctrine "has several difficulties, the first being that it has no basis in our cases").

<sup>246</sup> *Id.* at 878.

promises by the government. In this way Souter's rule tracks the language in *Skelly*; again this is done without commentary.

Souter's emphasis on the government's ability to apply the new law to the plaintiff is the key to both his statement of the unmistakability doctrine and his rule as to whether the doctrine applies.

The cases extending back into the 19th-century thus stand for a rule that applies when the Government is subject either to a claim that its contract has surrendered a sovereign power (e.g., to tax or control navigation), or to a claim that cannot be recognized without creating an exemption from the exercise of such a power (e.g., the equivalent of exemption from Social Security obligations). The application of the doctrine thus turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government.<sup>247</sup>

This language seems crafted to sound generally applicable, like the general rule from the unmistakability cases, even though it significantly narrows the focus of the doctrine as much as possible without directly contradicting the federal cases in which the Court did in fact apply the unmistakability doctrine.

Souter squares *Cherokee Nation* and *Merrion* with his theory by explaining that both involved claims for damages and therefore there was no danger of blocking the government's ability to exercise a sovereign power. This does explain *Merrion*, since the plaintiffs alleged the tribe had promised not to impose the disputed tax. Awarding damages for having to pay the tax is logically equivalent to an injunction against applying the tax to plaintiffs. This does not work quite so neatly with *Cherokee Nation*, however. In *Cherokee Nation*, plaintiffs brought a takings case seeking damages for the government's dredging of a navigational channel in the tribe's riverbed.<sup>248</sup> The problem was that the Court reversed the lower court for using an improper balancing test to decide whether compensation was due. "Applying this [balancing] test, the [lower] court concluded that though the Cherokee Nation could not interfere with the United States' exercise of the navigational servitude, it had a right to compensation for any consequent loss of property or diminution in value."<sup>249</sup> This distinction, which was overruled by the Supreme Court, parallels the reasoning of the circuit court in *Winstar*, which Souter upheld: enforcing

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<sup>247</sup> *Id.* at 878-79 (footnote omitted).

<sup>248</sup> See *United States v. Cherokee Nation*, 480 U.S. 700, 701 (1987).

<sup>249</sup> *Id.* at 703 (referring to *Cherokee Nation v. United States*, 782 F.2d 871, 877 (1986)).

the alleged contract by paying damages would not prevent the exercise of the sovereign power that gave rise to damages. Certainly, *Cherokee Nation* is concerned with rejecting the incorrect balancing test, but the decision also shows the Court using the unmistakability doctrine to interpret the government's promise. *Cherokee Nation* does not support the distinction between damages and an injunction that Souter puts forth to decide whether the unmistakability doctrine applies.

Souter's rule on applicability depends on the Court performing an interpretative step of its own as a way of deciding whether to apply the unmistakability defense:

*So long as such a contract is reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of [a governmental] power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it.*<sup>250</sup>

In performing this initial interpretation, however, Souter intends that the Court should read into the contract governmental promises to pay damages. This is clear from Souter's approach of interpreting the regulatory agreements before analyzing the unmistakability doctrine:

We read this promise as the law of contracts has always treated promises to provide something beyond the promisor's absolute control, that is, as a promise to insure the promisee against loss arising from the promised condition's nonoccurrence. Holmes's example is famous: "[i]n the case of a binding promise that it shall rain tomorrow, the immediate legal effect of what the promisor does is, that he takes the risk of the event, within certain defined limits, as between himself and the promisee."<sup>251</sup>

Thus, the Holmesian interpretive presumption is to find a promise to pay damages whenever a promisor promises anything "beyond the promisor's absolute control."<sup>252</sup> In combination, these passages mean that the Court

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<sup>250</sup> *Winstar*, 518 U.S. at 880 (emphasis added).

<sup>251</sup> *Id.* at 868-69 (quoting OLIVER WENDELL HOLMES, *THE COMMON LAW* (1881), reprinted in 3 *THE COLLECTED WORKS OF JUSTICE HOLMES* at 268 (S. Novick ed., 1995)) (footnote omitted).

<sup>252</sup> The fact that actions of Congress are beyond the absolute control of an agency raises another issue, ignored by Souter, that is addressed below in discussion of the express delegation doctrine.



is to apply the Holmesian presumption of damages and then ask whether the Court can conceive of a damages remedy that would still allow the government to apply the new law to the plaintiffs. If the Court can find such a damages remedy the government may not raise the unmistakability defense.<sup>253</sup> As a practical matter, the only occasions where Souter's rule could allow the unmistakability defense are the tax cases or situations, like *POSSE*, that amount to a specifically targeted tax or fee for participation in a government program.<sup>254</sup>

*b. The Plurality's Rule is Inconsistent with Unmistakability Case Law and Neighboring Jurisprudence of Economic Due Process*

As discussed above, the early state cases applied the unmistakability doctrine in their initial analysis of the contract. Application did not depend on the nature of the claim. Indeed, in *Charles River Bridge* and *Chenango Bridge* plaintiffs sued for both damages and injunctions, but this fact did not in any way affect the Court's analysis. Unfortunately, the unmistakability cases, and the parallel cases that refused to apply unmistakability, did not engage in any dialogue that might have clarified when each analysis should apply. This failure to define the threshold question left the door open for Souter to create a new rule for when to apply the doctrine, without having to explain away any competing analysis about when the doctrine should apply. On balance, the state unmistakability case law is better described by the rule from the *Delaware Railroad Tax Case*—strict construction—than by the language about preserving sovereign “power” from *Skelly*. Souter quotes both and does not mention their key difference in scope; the better reconciliation of the two quotes is that the language

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<sup>253</sup> Schwartz is surely correct to criticize Souter for trying to de-emphasize the importance of the Holmesian presumption in reaching his construction of the agreements: “[T]he contracts were construed not to constrain the Government’s sovereign authority only because of reliance on Holmes’s approach to reading a contract[.]” Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 507 (“Justice Souter turns a blind eye to the fact that, under his own account, the Government never made the promise he posits.”). *Id.* at 537. Breyer ignores this aspect of Souter’s analysis.

<sup>254</sup> *But cf.* Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 497 (concluding that Souter would apply unmistakability doctrine “only when injunctive relief is sought . . . [or] when damages are sought that would be tantamount in practical effect to such injunctive relief”). Neither Schwartz nor Souter seem to appreciate the extent to which this equivalency notion is manipulable by plaintiffs. *See infra* text accompanying notes 284-285.

about preserving power from *Skelly* is merely the rationale behind the rule of strict construction. The unmistakability cases seem to have assumed all along that even damages remedies have some effect on sovereign power.

It seems clear that Souter's rule would require reversal of most of the state unmistakability cases. Most of these involved regulation of utility rates charged to retail customers. These cases did not involve payment of taxes or fees to the government. Subsequently lowering the permissible rates below the maximums set in the charters presumably reduced profits. But requiring the government to pay damages for lost profits would not be the functional equivalent of an injunction against the new lower rates. The injunction would not seem to have any direct affect on the municipality's budget, in any event. Presumably there could be indirect budgetary effects supporting the city's need to change its rate regulations, but this is the traditional rationale for why we need an unmistakability doctrine (not why we need to be done with it). Souter's revision of the unmistakability doctrine thus contradicts most of the state unmistakability holdings.

A majority of the Court criticized Souter's adoption of his new rule. Scalia wrote in concurrence: "[Souter's] approach has several difficulties, the first being that it has no basis in our cases, which have not made the availability of these sovereign defenses (as opposed to their validity on the merits) depend upon the nature of the contract at issue."<sup>255</sup> In dissent, Rehnquist criticized Souter's rule as contrary even to the federal unmistakability cases.<sup>256</sup> Souter himself comes close to admitting the newness of his rule when he explains why there are so few federal unmistakability cases:

But the want of more developed law on limitations independent of the Contract Clause is in part the result of *applying the unmistakability canon of construction to avoid this doctrinal thicket*, as we have done in several cases involving alleged surrenders of sovereign prerogatives by the National Government and Indian tribes.<sup>257</sup>

So while the Court has applied the doctrine "several" times in the past, under Souter's new rule it is clear that the unmistakability doctrine would *not* apply in the cases he refers to, i.e. *POSSE*, *Cherokee Nation*, and *Merrion*. When judged against prior cases, then, Souter's rule is a major departure. Although it does not flatly contradict specific language in

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<sup>255</sup> *Winstar*, 518 U.S. at 919 (Scalia, J., concurring).

<sup>256</sup> *See id.* at 926 (Rehnquist, C.J., dissenting).

<sup>257</sup> *Id.* at 876 (emphasis added).

any unmistakability case, this is due more to the ambiguities in the threshold issue in the unmistakability cases than to Souter's fidelity to their holdings.

Souter might have chosen the different strategy of putting the federal unmistakability doctrine on a different footing than the state unmistakability doctrine. This is the course suggested by Breyer in his concurrence. Breyer argues that the federal cases relied on weak interpretive presumptions.<sup>258</sup> This seems correct for *POSSE* and *Cherokee Nation*, as explained in the section above, though not for *Merrion*.<sup>259</sup> But if Souter followed this strategy, he would run into two problems previewed in the previous section. First, more visibly relying only on federal cases would highlight the doctrinal problems *Winstar* creates. *Winstar* creates a new tension between the unmistakability defense available to the states and that available to the federal government. Souter began his unmistakability analysis by noting that the doctrine applies to all levels of sovereignty in the American system, and by hinting that the state cases are equally informative of the doctrine. But his much more careful analysis of the

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<sup>258</sup> See *id.* at 914-16.

<sup>259</sup> Breyer employs circular logic in explaining away *Merrion*. He correctly notes that *Merrion* viewed the "silence" in the lease agreement about the tribe's taxation power as ambiguous as to whether any promises had been made about taxation, and that the unmistakability doctrine required such ambiguities to be read in favor of the government. Breyer then reasons:

Though the opinion contains language of "unmistakability," the Court was not called upon in *Merrion* to decide whether a sovereign's promise not to change the law (or to pay damages if it did) was clear enough to justify liability, because there was no evidence of *any* such promise in the "contracts" in that case.

*Id.* at 914-15. But the Court in *Merrion* found no such evidence precisely because it *applied* the unmistakability doctrine. Even more indicative of this circularity is Breyer's dependence on the Holmesian presumption of damages as the "evidence" that the government intended to bind itself to recognition of goodwill:

To be sure, it might seem unlikely, in the abstract, that the Government would have intended to make a binding promise that would oblige it to hold the thrifts harmless from the effects of future regulation (or legislation) in such a high-risk, highly regulated context as the accounting practices of failing savings and loans. But, as the plurality's careful examination of the circumstances reveals, that is exactly what the Government did.

*Id.* at 918. *Cf. id.* at 936 (Rehnquist, C.J., dissenting) (criticizing Breyer for relying on an implication-in-law that Breyer mistakes for a factual finding of the Court).

federal cases strongly suggests that he deems it necessary to reconcile his new rule only with *holdings* from the federal government cases. After all, Souter would have faced insurmountable difficulty reconciling his theory with the state unmistakability cases, such as *Rogers Park*, had he analyzed them in the same depth. Therefore, the states are left with the *Rogers Park* line of cases as the unmistakability defense, while the federal government, under *Winstar*, has essentially no unmistakability defense left. As explained above, to the extent these differ, one would expect the federal government to have the stronger defense, yet Souter's rule leaves the states with the stronger defense against liability, at least against damages.

An aggressively conservative reading of *Winstar* might argue that *Winstar* did in fact overrule *Rogers Park* on the state side. This argument would rely on the language from *Merrion* and the *Sinking Fund Cases* that the federal government enjoys only the same unmistakability defense to contract liability as the states. But this argument would only cure the inconsistency with *Rogers Park*; it would do nothing to cure the other glaring doctrinal inconsistency created by *Winstar*. Now the federal government faces a much more difficult liability standard when it impairs *regulatory* agreements than when it impairs *private* contractual rights. A look at the new grid may be useful:

CONSTITUTIONAL STANDARDS TO UPHOLD GOVERNMENTAL  
INFRINGEMENT ON CONTRACT RIGHTS:  
HIGH, MEDIUM OR LOW?

	State Government: Contracts Clause	Federal Government: Due Process Clause
Private Contractual Obligations	Medium standard: Compare <i>Spannaus</i> with <i>Energy Reserves</i>	Low standard: <i>Usery, Mottley, et al.</i>
Regulatory/Governmental Obligations	Low standard: <i>Rogers Park, Los Angeles City Water</i> (or High standard: <i>Winstar</i> )	High standard (to avoid damages): <i>Winstar</i>

Doctrinally, *Winstar* creates a great deal of definitional pressure to distinguish the *Usery* line of cases, which set low standards under the Due Process Clause to uphold federal legislation, from the new *Winstar* rule which makes it very difficult for the federal government to escape liability. Souter does not mention this problem, probably because he rejects the distinction between regulatory agreements and private contracts as

incoherent,<sup>260</sup> even though this is evidently the major distinction between *Winstar* and the economic due process cases. Thus, even under an aggressively conservative reading, *Winstar* is inconsistent with surrounding economic due process doctrine. Moreover, on a logical level, one would expect the government (state or federal) to face a more lenient standard when it reneges its regulatory promises because there is a strong public interest in protecting the government's ability to enact new legislation and amend regulatory strategies and goals.

The second major problem with setting *Winstar* upon a separate, federal basis is that regulatory agreements do not appear to fit neatly within the Tucker Act. As noted above, Souter simply sets aside the "anterior question whether there were contracts at all between the Government and respondents."<sup>261</sup> Given the depth of Souter's analysis, it is disappointing that he does not explore the issue of whether the regulatory approvals should be considered contracts at all. For example, criminal plea agreements have never been held to support contractual damages under the Tucker Act, even though courts generally use contractual canons of construction to interpret the provisions of plea agreements. Regulatory agreements are more like plea agreements than private contracts in the sense that they do not generally make any provision, either expressly or implicitly, for payment of damages.

Moreover, Souter's use of the Tucker Act to support contract damages for breach of regulatory agreements seems to run afoul of the Anti-Deficiency Act,<sup>262</sup> which requires appropriations for funds paid out for judgment liabilities on government contracts. The dissent in *Winstar* argues that the plurality's use of the Holmesian presumption "seems the very essence of a promise implied in law, which is not even actionable under the

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<sup>260</sup> Justice Rehnquist raises the "dual roles of Government" in discussing the sovereign acts doctrine. *Id.* at 931 (emphasis in original). Justice Souter responds: "Such a distinction would raise enormous analytical difficulties[.]" *Id.* at 886.

<sup>261</sup> *Id.* at 860.

<sup>262</sup> The Anti-Deficiency Act, 31 U.S.C. § 1341, provides:

(a)(1) An officer or employee of the United States Government or of the District of Columbia government may not—

(A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation;

(B) involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.

31 U.S.C. § 1341 (1982).

Tucker Act, rather than a promise implied in fact, which is.<sup>263</sup> By treating the government's contractual liability as based on fundamental attributes of sovereignty, Souter can sidestep this flaw in his reasoning without attracting a great deal of attention.

After all, Souter could easily have based his analysis in part upon the Due Process Clause. His analysis of the unmistakability doctrine relies not on the Tucker Act but on inherent limits of sovereignty under the American rule,<sup>264</sup> apparently because the state unmistakability cases relied on the Contracts Clause, which does not apply to the federal government.<sup>265</sup> In his section on the sovereign acts doctrine, Souter cites a famous due process decision and defends the citation against the dissent's criticism by saying: "it would be surprising indeed if the sovereign acts doctrine, resting on the inherent nature of sovereignty, were not shaped by fundamental principles about how sovereigns ought to behave."<sup>266</sup> Souter could easily have argued that fundamental fairness requires the government to keep its promises, but he stopped well short of this.

Direct reliance on the Due Process Clause would raise the question of why private parties do not assume the risk of regulatory change in heavily regulated industries. This is a traditional due process notion, labeled by one critic the "heavily regulated industry doctrine,"<sup>267</sup> which has been applied widely in both contract law and criminal law. There is much less concern for protecting fundamental fairness in heavily regulated industries because private parties should reasonably expect changes in regulation and so should not rely on a given regulatory environment remaining constant. Starting with a due process perspective, therefore, inevitably tends to favor the government's position in *Winstar*. For Souter to avoid this pitfall, he

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<sup>263</sup> *Winstar*, 518 U.S. at 930 (citing *Hercules v. United States*, 516 U.S. 417 (1996)).

<sup>264</sup> In analyzing the Court's holding in *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810), Souter wrote that Chief Justice Marshall based his conclusions on "the two distinct reasons that the intrusion on vested rights by the Georgia Legislature's Act of repeal might well have gone beyond the limits of 'the legislative power,' and that Georgia's legislative sovereignty was limited by the Federal Constitution's bar against laws impairing the obligation of contracts." *Id.* at 873-74.

<sup>265</sup> The only alternative would have been a different rule for the states and federal government.

<sup>266</sup> *Winstar*, 518 U.S. at 898 n.43.

<sup>267</sup> Robert A. Graham, Note, *The Constitution, the Legislature, and Unfair Surprise: Toward a Reliance-Based Approach to the Contract Clause*, 92 MICH. L. REV. 398 (1993) (urging further reliance on the heavily regulated industry doctrine, or "HRID").

must implicitly treat the government as any other private, contracting party, and apply contractual principles that limit the context which the court may analyze in reaching its decision. Souter is hardly the first to take advantage of this style of argument, to be sure. Each of the state cases, like *Detroit Citizens*,<sup>268</sup> that found the state liable without consideration of the unmistakability doctrine employed similar reasoning. Souter's reasoning carefully minimizes the risks of exposing each of these potential flaws in his analysis.

Professor Schwartz argues that *Winstar* amounts to the victory of congruence over exceptionalism in interpreting regulatory agreements.<sup>268</sup> This aptly describes the net results of Souter's reasoning and his common ground with Scalia. Perhaps a slightly deeper explanation is that Souter's analysis demonstrates the internal logic that can be achieved by starting from the premise that regulatory agreements should be treated as contracts. One hazard to avoid is mentioning the parallel universe of analysis that begins with a due process emphasis on the actions of the government *as a sovereign*. The contractual analysis (e.g., the Holmesian presumption about promises it will rain tomorrow), excludes the broader context necessary to analyze the fundamental fairness of *governmental* actions. The only relevant context in contractual analysis is intent of the parties.<sup>269</sup> The contractual analysis ignores the public policy rationale for applying different contract rules to the government. But the fact that the taxpayers must pay for any contract damages incurred by the government has rightfully justified the many different rules for government contracting.

However, because regulatory agreements such as the merger approvals in *Winstar* involve governmental exercise of sovereign powers, the agreements can also be analyzed from the due process perspective of fundamental fairness. This perspective starts from the presumption that the government has broad latitude to exercise sovereign control, subject to certain limits. The key difference from contractual analysis is that due process analysis looks much more broadly to the full context of the government's actions; it does not look only at the intent of the parties. Perhaps the most disappointing aspect of Souter's analysis is that it

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<sup>268</sup> See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 481. Schwartz uses "congruence" to mean applying the same contract rules the government as to private parties, and "exceptionalism" to mean allowing the government to use special defenses. See *id.*

<sup>269</sup> It is interesting to note that Holmes penned his contractual analysis prior to enactment of the Tucker Act, when there was no reason to think that such contractual analysis would be applied to the federal government.

repeatedly buries the deeper threshold issues of whether the agreements are contracts and whether the appropriate starting place is contractual analysis or due process analysis.

Souter's unmistakability rule blazes bold new ground by drastically limiting the availability of the unmistakability defense. While his analysis does not contradict the specific language in any unmistakability cases, this is enabled by the cases' failure to answer the threshold question of when the doctrine applies. It seems clear that Souter's analysis would reverse most, if not all of the state unmistakability cases, but the opinion does not own up to this. The plurality's rule creates important and illogical inconsistencies with respect to both the state unmistakability doctrine and the federal economic due process jurisprudence. Finally, *Winstar* fails, like most unmistakability cases, to answer the key underlying questions of when it makes more sense to apply congruence-based contract rules to the government and when it makes more sense to start with the due process perspective that looks more broadly to the full context surrounding the government's subsequent legislation.

*c. The Concurrences of Breyer and  
Scalia Fear the Unmistakability Doctrine Allows  
the Government to Make Illusory Promises*

Justice Breyer signed onto the lead opinion but also filed his own concurring opinion. Breyer's analysis focuses purely on the contractual intent of the parties. Breyer does little to explain why this perspective is superior to the due process perspective described above, other than to note that the contracts involved in *Winstar* "resembl[ed]" those in *Lynch* and *Perry*.

Instead, Breyer puts forth two main reasons why the unmistakability rule does not save the government here. First, as noted above, the decisions involving federal or tribal governments did not rely on a strong interpretive presumption; a persuasive argument for *POSSE* and *Cherokee Nation* but not for *Merrion*. Second, Breyer argued that the government could not explain why the unmistakability doctrine would not apply to all government contracts. Souter raises essentially the same issue when he criticizes the dissent for failing to persuasively distinguish *Lynch*.<sup>270</sup>

The government's brief did little to allay this fear when it argued that any "substantial damages" award against the government implicates the

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<sup>270</sup> See *Winstar*, 518 U.S. at 885.



sovereign power protected by the unmistakability doctrine.<sup>271</sup> Breyer responded:

But this rationale has no logical stopping point. It is difficult to see how the Court could, in a principled fashion, apply the Government's rule in this case without also making it applicable to the ordinary contract case (like the hypothetical sale of oil) which, for the reasons explained above, are properly governed by ordinary principles of contract law.<sup>272</sup>

Breyer's brief summary of the government's argument does no significant disservice to the government's position. Like most of the unmistakability cases, the government's brief failed to put forth much of a rationale for deciding when to apply the unmistakability doctrine and when to treat government agreements like private contracts.

Breyer's second argument invokes the very legitimate fear that a contrary result would allow the government to make illusory promises in its regulatory agreements. Perhaps the most unfortunate example from the government's brief appears in its analysis of the goodwill agreement in *Winstar*. Unlike Glendale's or Stateman's, *Winstar's* agreement contained a clause explaining that the goodwill agreement would apply instead of any contrary regulations. But the government's brief argued:

The integration clause did not make the forbearance letter and Bank Board Resolution into contractual promises that *Winstar* could continue to capitalize goodwill in the future, even if regulatory policy or the governing statute should change. Those documents *reflected then-current regulatory policy* and stated the steps *Winstar* needed to take to capitalize goodwill—and the amortization schedule that could be used in doing so—under that policy.<sup>273</sup>

The government's brief emphasized its interpretation throughout that the agreements merely reflected the "then-current" policy. It is very difficult to see daylight between this argument and the conclusion that the government made illusory promises. After all, if regulatory agreements are not contracts, what are they and when should courts enforce them? Part II

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<sup>271</sup> See *id.* at 917 (quoting Petitioner's Brief at \*21, *United States v. Winstar Corp.*, 518 U.S. 839 (1996) (No. 95-865) (1996 WL 99716)).

<sup>272</sup> *Id.* (citation omitted).

<sup>273</sup> Petitioner's Brief at \*29, *United States v. Winstar Corp.*, 518 U.S. 839 (1996) (No. 95-865) (1996 WL 99716) (emphasis added).

of this Article attempts to answer this question, which is but another restatement of the lingering ambiguity in the unmistakability cases and doctrine. The government's failure to provide a convincing theory for this explains, perhaps more than any other reason, the Court's reluctance to use the unmistakability doctrine to shield the government from liability.

Justice Scalia filed a concurring opinion joined by Justices Kennedy and Thomas. Scalia's opinion styles itself as quite different from Souter's lead opinion, but the net result is strikingly similar. Scalia criticizes the plurality for making up a new rule governing applicability of the unmistakability doctrine. Scalia then purports to apply the unmistakability doctrine.<sup>274</sup> Scalia describes the doctrine as "simply a rule of presumed (or implied-in-fact) intent"<sup>275</sup> that takes into account the fact that "[g]overnments do not ordinarily agree to curtail their sovereign or legislative powers[.]"<sup>276</sup> Scalia is persuaded, however, that the plaintiffs have overcome this presumption:

Their claim is that the Government quite plainly promised to regulate them in a particular fashion, into the future. They say that the *very subject matter* of these agreements, an essential part of the *quid pro quo*, was Government regulation; unless the Government is bound *as to that regulation*, an aspect of the transactions that reasonably must be viewed as a *sine qua non* of their assent becomes illusory. I think they are correct.<sup>277</sup>

Scalia argues that since the core of the agreement was government regulation, the government's promise to regulate this way is clear enough to overcome the unmistakability doctrine. This clearly ignores that *all* unmistakability cases involve agreements about government regulation. Scalia's blatant revision of the unmistakability doctrine would shock the conscience if it were not backed up by the same fear of illusory promises that apparently drove each of the majority's other opinions: "Indeed, it is hard to imagine what additional assurance that the course of regulation would not change could have been demanded—other than, perhaps, the Government's promise to keep its promise."<sup>278</sup> Such a second promise is essentially what *Rogers Park* and *Los Angeles City Water* required. But

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<sup>274</sup> See *Winstar*, 518 U.S. at 920.

<sup>275</sup> *Id.*

<sup>276</sup> *Id.* at 921.

<sup>277</sup> *Id.* (emphasis added).

<sup>278</sup> *Id.* at 922.

without a theory as to when to apply the doctrine, it appears to give the government the power to make illusory promises.

*d. Rehnquist's Dissent*

In addition to criticizing the plurality's restriction of the unmistakability doctrine, Justice Rehnquist attacks Souter's lead opinion on a purely logical level. First, Rehnquist criticizes Souter for interpreting the agreements first and only later deciding whether to apply the unmistakability doctrine. "[I]f a canon of construction cannot come into play until the contract has first been interpreted as to liability by an appellate court, and remanded for computation of damages, it is no canon of construction at all."<sup>279</sup> But the problem with Souter's interpretation is less a logical one than infidelity to precedent. As discussed above, the unmistakability cases applied the doctrine in order to reach their interpretation of the contract. As a matter of logic, however, damage awards and injunctions often face different requirements and analysis. And it is certainly true that damages, as a general matter, have less impact on government's sovereign power to govern than injunctions.<sup>280</sup>

Souter responds to the dissent with a footnote explaining that there is no "question-begging" in applying different rules of construction to the same agreement: "A contract may reasonably be read under normal rules of construction to contain a [risk-shifting] provision that does not satisfy the more demanding standard of unmistakable clarity. If an alleged term could not be discovered under normal standards, there would be no need for an unmistakability doctrine."<sup>281</sup> There is no internal contradiction in first applying the Holmesian presumption of promises to pay damages first and then, if no such promises are found, allowing the unmistakability defense. While this may be a little more post-modern than one would expect from Souter, it clearly answers any concern over his analysis contradicting itself logically. The net result is simply that the unmistakability

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<sup>279</sup> *Id.* at 930-31.

<sup>280</sup> This distinction assuredly breaks down in the face of the huge liabilities likely to be imposed as a result of *Winstar*, which certainly would have given Congress pause if it had known about them in advance. *Accord* Krent, *supra* note 165, at 1537, 1568-78 (arguing that damages would affect Congress's decision making); *but see* Richard H. Seamon, *Separation of Powers and the Separate Treatment of Contract Claims Against the Federal Government for Specific Performance*, 43 VILL. L. REV. 155, 159 (1998) (contending that the specific performance remedy is "more intrusive" on government).

<sup>281</sup> *Winstar*, 518 U.S. at 880 n.24.

lity defense will seldom, if ever, be available. *Winstar* creates a new, broadly available cause of action against the government, and this raises serious questions about the Court's purported commitment to judicial restraint.<sup>282</sup> One could certainly question the wisdom of this regime, but there is no internal contradiction to its analysis.

Rehnquist also argues that Souter's rule allows future plaintiffs to draft their pleadings strategically to avoid the unmistakability doctrine:

But sophisticated lawyers in the future, litigating a claim exactly like the one in *St. Louis* [a tax exemption case], need only claim that the sovereign implicitly agreed not to change their tax treatment, and request damages for breach of that agreement. There will presumably be no unmistakability doctrine to contend with, and they will be in the same position as if they had successfully enjoined the tax.<sup>283</sup>

Souter responds that the determination of whether damages are equivalent to an injunction is made by the Court, not by the plaintiff's request for remedy,<sup>284</sup> and Rehnquist's analysis does not appear to take this fully into account. But there is considerable wiggle room left in Souter's theory because future plaintiffs need only posit a slight difference between their damages theories and an injunction for the Court to have grounds to avoid the unmistakability doctrine. Given the variety of contract damages theories, as exemplified in the dispute raging in the *Winstar* remands,<sup>285</sup> this should not be too challenging. The most common theory of contract damages—lost profits based on an expectation theory—might very well work even in a tax exemption case because the plaintiff could argue that it suffers more loss than the additional tax revenue by losing the opportunity to reinvest those funds in its profitable enterprise. Thus, under an expectation damages theory, the loss to the plaintiff is greater than the gain to the government collecting the tax, and the damages award is not equivalent to an injunction.

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<sup>282</sup> Indeed, Souter's theory looks like an example of the Court creating a new cause of action. *Cf. Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971) (recognizing damages actions for violations of constitutional rights).

<sup>283</sup> *Winstar*, 518 U.S. at 928.

<sup>284</sup> *See id.* at 880.

<sup>285</sup> *See, e.g., Decision is Deferred in Key Goodwill Case*, AM. BANKER, Jan. 6, 1999, at 3 (summarizing the three major damages theories: (1) lost profits; (2) amount saved by the government for avoiding initial closing of the failing target thrifts; and (3) out-of-pocket costs incurred as a result of nixing goodwill).

Rehnquist's dissent otherwise fails to shake the foundation of the majority's various arguments, largely because Rehnquist attacks from within the structure laid out by Souter instead of imposing an entirely different analysis upon the case. For example, Rehnquist discusses the unmistakability doctrine by analyzing in depth only the cases involving federal or tribal regulatory agreements. This leaves his argument open to Breyer's response that the interpretive presumption necessary in those cases was weak and Souter's proviso that the damages in *Merrion* were equivalent to an injunction. Rehnquist similarly falls into the majority's analytic structure in analyzing the sovereign acts doctrine. As argued above, the underlying clash in *Winstar* and the other unmistakability cases is the threshold question of whether it makes sense to apply the doctrine and, so far at least, this question has boiled down to a choice between two parallel analyses: the pro-government analysis based on due process and the pro-liability analysis based on traditional private contract doctrine.

*e. Concluding Remarks on Unmistakability*

The idea of paying damages for the "taking" of contract rights has been floated by several scholars as a way to fill the gap between the Takings Clause and the Contracts Clause.<sup>286</sup> By allowing, and indeed encouraging, payment of damages, Souter's reasoning effectively answers the call of these scholars by providing for money damages even though plaintiffs have not made out a case of a government taking. Souter relies on traditional takings argumentation for his unmistakability analysis:

Just as we have long recognized that the Constitution "‘bar[s] Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole,’" so we must reject the suggestion that the Government may simply shift costs of legislation onto its contractual partners who are adversely affected by the change in the law, when the Government has assumed the risk of such change.<sup>287</sup>

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<sup>286</sup> See, e.g., Epstein, *supra* note 128, at 703; J.D.B. Mitchell, *A General Theory of Public Contracts*, 63 JURID. REV. 60, 86 (1951) [hereinafter Mitchell, *A General Theory*] ("The result of the general principle here advanced is therefore that the public authority may be exempt from performing its contract according to its strict expression but that where this exemption results in loss to the individual contractor compensation should be payable save where that payment would offend the principle.").

<sup>287</sup> *Winstar*, 518 U.S. at 883 (quoting *Dolan v. City of Tigard*, 512 U.S. 374, 384, 114 S. Ct. 2309, 2316, 129 L. Ed. 2d 304 (1994) (quoting *Armstrong v. United States*, 364 U.S. 40, 80 S. Ct. 1563, 1569, 4 L. Ed. 2d 1554 (1960))).

*Dolan* and *Armstrong*, quoted in *Winstar*, are landmark takings decisions and the plurality's rule certainly functions just like a regulatory takings regime. Regulatory takings refers to the theory put forward by several conservative scholars that any diminution in property value caused by changes in government regulation should be compensable by the government under the Takings Clause.<sup>288</sup> The rationale is apparently that this would impose a strict cost-benefit discipline on the government because the government would only be able to afford those regulations that resulted in a net increase in the total property values of the polity and therefore an expansion of the government's tax base.<sup>289</sup> Regulatory takings must therefore make an exception for government regulation in the form of taxes. Property taxes obviously reduce the value of real estate, but the regulatory takings theory must allow for this form of regulation to go uncompensated so that the theory does not bankrupt government ab initio. The Court has yet to recognize this theory of regulatory takings explicitly.<sup>290</sup>

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<sup>288</sup> See, e.g., RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985); Douglas W. Kmiec, *The Original Understanding of the Takings Clause is Neither Weak Nor Obtuse*, 88 COLUM. L. REV. 1630 (1988); W. Keith Noel, *Just Compensation: The Constitutionally Required Remedy for Regulatory Takings*, 55 U. CIN. L. REV. 1237 (1987); ROBERT NOZICK, *ANARCHY, STATE, AND UTOPIA* (1974).

<sup>289</sup> Among the obvious problems with this theory is its reduction of the value of all government programs to the financial dimension. Environmental regulation, for example, would only "create value" if it showed up in higher land values or longer life to taxpayers. Less quantifiable criteria like morality are ignored. There is also a significant lag between a regulation's implementation and such increases in value, which government might have difficulty financing in the face of immediate claims for compensation. Of course, there are also huge feasibility problems: one can easily imagine a bureaucracy much like an anti-IRS would be necessary to process the millions of annual claims that would be created. Regulatory takings theory has many critics. See, e.g., Gregory S. Alexander, *Takings and the Post-Modern Dialectic of Property*, 9 CONST. COMMENTARY 256 (1992); J. Peter Byrne, *Ten Arguments for the Abolition of the Regulatory Takings Doctrine*, 22 ECOLOGY L.Q. 89 (1995); William B. Stoebuck, *Police Power, Takings, and Due Process*, 37 WASH. & LEE L. REV. 1057 (1980); Richard G. Wilkins, *The Takings Clause: A Modern Plot for an Old Constitutional Tale*, 64 NOTRE DAME L. REV. 1 (1989); Note, *Taking Back Takings: A Coasean Approach to Regulation*, 106 HARV. L. REV. 914 (1993). Cf. Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

<sup>290</sup> But cf. *Eastern Enterprises v. Apfel*, 118 S. Ct. 2131 (1998) (the four vote plurality endorsed a regulatory takings theory). Interestingly, Souter dissented in

Souter's unmistakability rule parallels regulatory takings theory.<sup>291</sup> The only additional requirement for compensation under Souter's unmistakability rule is an agreement with the government. But the breadth of Souter's reasoning—and his failure to address the threshold issue—suggests that almost any sort of government permit, license, grant, or approval will suffice. Souter's reasoning does not seem to exclude, for example, the building permit issued to David Lucas, the real estate developer in South Carolina who won a recent takings claim in *Lucas v. South Carolina Coastal Commission*.<sup>292</sup> Much of the reasoning in *Lucas* focused on the fact that the environmental regulation that prevented Lucas from building houses on his land destroyed *all* economic value of his land.<sup>293</sup> One of the several problems with the Court's opinion in *Lucas* was its reliance on this odd factual finding of the state trial court, and Lucas almost certainly would not have prevailed without the finding that his land's value was completely destroyed. Yet another case, identical to *Lucas* but for a more reasonable finding of diminution in value, could seemingly make out a contract claim under *Winstar*. Lucas' contract with the state was his building permit, and the government breached by enacting the wetlands protection legislation that barred him from developing the property he purchased. Instead of calling it a taking, the plaintiff would allege breach of contract and refer to his demand for payment as "damages" instead of "compensation." Given the difficulty in rationalizing takings law, and the resulting difficulty in imposing a regulatory takings regime upon the jurisprudence, it is hard to escape the conclusion that *Winstar* represents a first step toward an end-run around the takings morass to establish regulatory takings through a contract theory.

In sum, *Winstar* preserves very little of the unmistakability doctrine. Its new damages cause of action creates tremendous definitional pressure relative to economic due process jurisprudence. Although the analyses of Justices Souter and Scalia style themselves as different, in reality they

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*Eastern Enterprises*, joining two separate dissenting opinions. One of these, written by Justice Stevens, emphasized the fact that the company plaintiff had reached an agreement to provide its employees with lifetime health benefits, implying that later federal legislation ordering plaintiffs to do so did not undermine their reasonable expectations. *See id.* at 2160.

<sup>291</sup> *But cf.* *West River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507 (1848) (rejecting a Contracts Clause claim where the state condemned a bridge it had chartered with exclusivity provisions similar to those in *Charles River Bridge*, reasoning that the remedy lies solely in the Takings Clause).

<sup>292</sup> *Lucas v. South Carolina Coastal Comm'n*, 505 U.S. 1003 (1992).

<sup>293</sup> *See id.* at 1017.

function very similarly. Both would require the reversal of most of the state unmistakability cases, though they leave it ambiguous whether they intend to reverse the state cases or to differentiate the unmistakability defense available to the states from that available to the federal government. *Winstar* manages all this without directly contradicting the language in any of the earlier unmistakability cases, largely because the earlier cases avoid the threshold issue of when the doctrine applies. *Winstar* effectively avoids this issue by making the defense almost impossible to raise, but more importantly, the majority decisions also avoid the fundamental threshold issue from which perspective to begin the analysis: from a contractual analysis that consciously ignores any context beyond intent of the parties, or from a due process analysis that looks to the broader context necessary to decide if a *government* is acting consistent with the minimum standards of fundamental fairness. The next section explores what should have been the government's strongest defense in *Winstar*: the express delegation doctrine. This defense should have carried the day, in part because its seminal case, *Home Telephone & Telegraph Co. v. Los Angeles*,<sup>294</sup> is the only Supreme Court decision that successfully addresses (albeit in a limited way) this threshold issue.

#### *D. Express Delegation Doctrine*

More so than the other two defenses considered in *Winstar*, the unmistakability and express delegation doctrines are best understood in relation to each other. Both doctrines arose in Contracts Clause cases having similar fact patterns, and both balance similar concerns for government accountability in contracting. Unmistakability is a presumption used to interpret the disputed contract, which often takes the form of legislation. The presumption is that the government did not make promises about the exercise or restraint of its sovereign powers unless the intent to make such promises appears in unmistakably clear language in the legislation. For example, in order for a state to enter into a long-term contract promising to let a utilities company charge certain rates to customers, the legislature will need to use unmistakably clear language in the contract that the state is bargaining away its sovereign power to regulate that company's rates for the period of the contract. The presumption, therefore, aims to create a healthy disincentive for legislatures to enter into long-term contracts; for to do so, the language in the contract or legislation must make it plain to

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<sup>294</sup> *Home Telephone & Telegraph Co. v. Los Angeles*, 211 U.S. 265 (1908).



the public that the legislators knew full well that their action would bind the state for the entire term of the contract.

The express delegation doctrine creates a similar pressure on state legislators to be frank about how much they authorize cities to bind the state through contracting. Express delegation is the presumption that a governmental subunit, such as a municipality, does not possess the power to bind the state, unless the state statutes that grant regulatory authority to the city include unmistakably clear language that the city has the power to bargain away one (or more) of its delegated powers.<sup>295</sup> To extend the example above, in order for a city to enter into a long-term contract with a utilities company that binds the state, the state must have passed legislation expressly delegating to the city the power to bargain away the sovereign power to regulate that company's rates for the period of the contract.

There are, therefore, three levels of contract defenses the city could raise in this example. First, if the state's statutes gave the city no power to regulate utility rates, the contract would be *ultra vires*: simply beyond the city's regulatory powers. Second, if the city had the delegated power to regulate rates, but not the power to bargain away that power, the express delegation doctrine would apply and the courts should find no contract. This distinction is made in *Home Telephone & Telegraph*, discussed below. Finally, if the city had the authority to regulate rates and the authority to bargain away this delegated authority, the city's contract with the company would need to bargain away the power in unmistakably clear language. Otherwise, the unmistakability doctrine would apply and save the state (or the city) from contract liability. The express delegation doctrine aims to increase the accountability of the state legislators for knowingly delegating to cities (or other governmental units) the authority to make long term contracts that might come back to haunt the state. If several cities found themselves at the losing end of bad bargains, the express delegation doctrine would make it easier for the state's electorate to hold the state legislature responsible for allowing the cities to bind the state.

The express delegation doctrine should be thought of as a subset of the unmistakability doctrine, applicable when a governmental subunit enters into a regulatory agreement. This is fundamentally why the two defenses are better understood in comparison to one another. There are nevertheless subtle differences between the two doctrines. First, unmistakability looks at the language of the alleged contract while express delegation looks at the statutory language authorizing the governmental unit's regulation. Second,

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<sup>295</sup> *See id.*

there are dozens of unmistakability decisions but only a few express delegation decisions. Despite this, the strengths of the interpretive presumptions appear essentially the same. Third, while a few cases have recognized the federal government's ability to use the unmistakability defense, notwithstanding that the Contracts Clause only purports to bind the states, the express delegation doctrine has arisen only in cases involving state governments.<sup>296</sup> The next two subsections describe in more detail the strength of the presumptions employed in the major Supreme Court decisions.

The express delegation doctrine originated in the 1908 Supreme Court decision *Home Telephone & Telegraph*.<sup>297</sup> The express delegation doctrine provides the government with another special contract defense when the agreement is made by a political subdivision of a state, such as a city, county, or utility district. Stated simply, the doctrine requires that for a city to be bound to a regulatory agreement, not only must the promise to regulate in a certain way appear unmistakably clear in the agreement, but in addition, the city's statutory authority must contain unmistakably clear language that authorizes the city to make binding promises about its regulatory treatment. The doctrine can be thought of as a specific subset of the standard ultra vires defense for corporations and government agencies,<sup>298</sup> though it requires more than simply checking to see if the city has authority to regulate. It refers specifically to the authority to *contract* regarding regulation. Moreover, it employs the same sort of strict interpretive presumption as the unmistakability doctrine, although the express delegation doctrine applies the presumption to statutory language, not only to the language of the alleged contract. Very much like its predecessor, the unmistakability doctrine, the express delegation doctrine tries to locate political accountability for governmental decisions to enter into long-term regulatory agreements.

Two themes emerge from analysis of the express delegation doctrine. First, the search for statutory authority to contract goes a long way toward rationalizing the unmistakability and municipal utility cases. Treating the two doctrines as separate, therefore, leaves both less than fully explained and less coherent than they would be if seen as logically connected.

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<sup>296</sup> See discussion *supra* Part I.C.1.

<sup>297</sup> See *Home Tel. & Tel.*, 211 U.S. at 265.

<sup>298</sup> Cf. Leo P. Martinez, *Of Fairness and Might: The Limits of Sovereign Power to Tax After Winstar*, 28 ARIZ. ST. L.J. 1193, 1214 (1996) (discussing the ultra vires defense); Richard E. Speidel, *Implied Duties of Cooperation and the Defense of Sovereign Acts in Government Contracts*, 51 GEO. L.J. 516, 519 (1963).

Second, the doctrine treats cities as contracting entities distinct from the sovereign state, much like administrative law treats administrative agencies as distinct from Congress or the federal government. This raises the question of what to do with promises a city or a federal agency makes but for which the city or agency lacks the authority to bind the sovereign. Are these promises totally unenforceable because they are unenforceable against the sovereign? The Supreme Court decision in *Southern Utilities v. Palatka*,<sup>299</sup> suggests that an agency could be held to its promises, even while Congress, as the sovereign, retains the authority to overrule the agency's regulatory agreements. This theory is more fully developed in Part II.

The majority opinions in *Winstar* do not purport to overrule the express delegation doctrine, but they nonetheless dismiss it fairly quickly. This is unfortunate because it has the potential to clarify the law of government contracts and regulatory agreements, especially now that governments have delegated so much regulatory responsibility to cities and agencies.

### 1. *Express Delegation Doctrine Cases*

The facts of *Home Telephone & Telegraph* parallel the typical unmistakability cases discussed above. The City of Los Angeles granted a fifty-year franchise to a phone company, specifying the maximum allowable rates the company could charge customers. Shortly thereafter, the city lowered the maximum rates the company could charge customers, and the phone company sued.<sup>300</sup> The Court upheld the new lower rates. Justice Moody, writing for a unanimous Court, focused on the same sort of accountability concerns that support the unmistakability doctrine: "The surrender, by contract, of a power of government, though in certain well-defined cases it may be made by legislative authority, is a very grave act, and the surrender itself, as well as the authority to make it, must be closely scrutinized."<sup>301</sup> Scrutiny of "the surrender itself" is a clear reference to the unmistakability doctrine. Scrutiny of "the authority to make it" apparently refers to the traditional notion of ultra vires acts, but the Court signaled that it did not simply intend to analyze whether the city had the appropriate regulatory authority: "It was decided by the judge of the court below, and it is agreed by the parties, that . . . the charter conferred upon the city council . . . the power to prescribe charges for telephone service."<sup>302</sup>

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<sup>299</sup> *Southern Util. v. Palatka*, 268 U.S. 232 (1925).

<sup>300</sup> See *Home Tel. & Tel.*, 211 U.S. at 272.

<sup>301</sup> *Id.* at 273.

<sup>302</sup> *Id.* at 271. The Court quoted two state statutes. The first authorized the city "to regulate telephone service . . . and to fix and determine the charges for

Instead, the Court focused more specifically on whether the state had expressly delegated to the city *the power to bargain away* the regulatory power that the state had undeniably delegated to the city:

No other body than the supreme legislature (in this case, the legislature of the State) has the authority to make such a surrender, unless the authority is clearly delegated to it by the supreme legislature. *The general powers of a municipality . . . of the state are not sufficient. Specific authority for that purpose is required.*

It has been settled by this court that the State may authorize one of its municipal corporations to establish by an inviolable contract the rates to be charged by a public service corporation (or natural person) for a definite term, not grossly unreasonable in point of time, and that the effect of such a contract is to suspend, during the life of the contract, the governmental power of fixing and regulating the rates. But for the very reason that such a contract has the effect of extinguishing *pro tanto* an undoubted power of government, *both its existence and the authority to make it must clearly and unmistakably appear*, and all doubts must be resolved in favor of the continuance of the power.<sup>303</sup>

The Court viewed the express delegation rule as an extension of the unmistakability doctrine. The same sort of interpretive presumption required by the unmistakability doctrine was brought to bear not only on the agreement at issue, but also on the statutes allegedly authorizing the city to bargain away its regulatory power.<sup>304</sup> In support of the language quoted above, the Court cited numerous unmistakability cases, a few of which hinted at the issue of delegation. It also recognized the inconsistency in the unmistakability holdings: “differences, slight in themselves, may, through their relation with other facts, turn the balance one way or the other.”<sup>305</sup>

The Court then focused on the specific language in the city’s charter. The city had the power to “regulate” phone service and to “fix” rates. But

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telephones and telephone service[.]” *Id.* The second statute gave the city authority to charter telephone companies by ordinance. *See id.* at 272.

<sup>303</sup> *Id.* at 273 (emphasis added) (citations omitted).

<sup>304</sup> If a power were somehow inherent to a city, and did not come from a delegation from the state, presumably only the unmistakability doctrine would apply.

<sup>305</sup> *Id.* at 274. The Court cited *Freeport*, *Rogers Park*, and *Knoxville Water* as upholding the new government regulation and *Detroit Citizens’* and *Cleveland City Railway* as striking it down.

the charter did not authorize the city to enter into a contract as a legal equal with the water company and become bound by force of their meeting of the minds:

This is ample authority to exercise the governmental power of regulating charges, but it is no authority to enter into a contract to abandon the governmental power itself. . . . *It authorizes command, but not agreement.* Doubtless, an agreement as to rates might be authorized by the legislature to be made by ordinance. *But the ordinance here described was not an ordinance to agree upon the charges, but an ordinance "to fix and determine the charges."*<sup>306</sup>

The Court explained that the authority to *contract* must appear unmistakably in the city's charter or authorizing statutes. The Court demonstrated how well this rule works to rationalize the seemingly inconsistent lines of municipal regulation cases:

In *Los Angeles v. Los Angeles City Water Co.*, the contract was in specific terms ratified and confirmed by the legislature. In *Detroit v. Detroit Citizens' Street Ry. Co.*, the contract was made in obedience to an act of the legislature that the rates should be "established by agreement between said company and the corporate authorities." . . . In *Cleveland v. Cleveland City Ry. Co.*, the legislative authority conferred upon the municipality was described in the opinion of the court as "comprehensive power to contract with street railway companies . . ." In *Vicksburg v. Vicksburg Waterworks Co.*, the court said: "The grant of legislative power . . . authorizes the city . . . to contract with a party or parties who shall build and operate waterworks."<sup>307</sup>

Thus, the precise wording of the city's authorizing statutes is the key. Words like regulate, fix, and determine indicate that although the city has regulatory power, it does not necessarily have the power to bargain away the power. Words like contract, agreement, and consent of the company indicate the city has the power to bargain away its regulatory power.<sup>308</sup>

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<sup>306</sup> *Id.* (emphasis added).

<sup>307</sup> *Id.* at 277-78 (citations omitted).

<sup>308</sup> The *Home Telephone & Telegraph* opinion discussed *Freeport Water Co. v. Freeport*, 180 U.S. 587 (1901), a companion case to *Rogers Park*, that also upheld the city's new regulation. *Home Telephone & Telegraph* noted that Freeport's authorizing statute allowed it to "contract" for the construction of waterworks "at such rates as may be fixed by ordinance, and for a period not

The Court's direct comparison of the unmistakability cases and the utility congruence cases is so unusual that it may be unique among Supreme Court decisions. The rule from *Home Telephone & Telegraph* provides one way to decide when a city should be governed by the same contract rules as private parties: when the city has express statutory authority to contract as a private party. *Home Telephone & Telegraph* deserves jurisprudential respect for the simple reason that it provides a coherent theory of when to apply the unmistakability doctrine.

Unfortunately, the Court has done little to refine the express delegation doctrine after *Home Telephone & Telegraph*. The 1944 decision in *Keefe v. Clark*<sup>309</sup> was one of the few cases to resemble *Home Telephone & Telegraph* in its reasoning, but it did not even cite *Home Telephone & Telegraph*. In *Keefe*, the state of Michigan authorized drainage districts to issue bonds to fund draining swamps for development. In order to assure payment to the bondholders, the legislature required each drainage district to levy assessments on covered lands if the district's revenues were insufficient to pay the bonds in full. Later, the legislature passed another law allowing the sale of lands that a drainage district had seized for failure to pay assessments, but under the new law the buyers at such sales received unencumbered title even if the proceeds of the sale did not cover the delinquent assessment. Bondholders sued, claiming the security backing payment of their bonds had been eliminated in contravention of their contractual rights created by the first statute.<sup>310</sup> The Court found no violation of the Contracts Clause. The Court's analysis mixed the unmistakability presumption and references to the authority of the drainage districts. First, the Court seemed to approve of the state court's use of a delegation analysis suggestive of the express delegation doctrine: "The

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exceeding thirty years." *Home Tel. & Tel.*, 211 U.S. at 277 (quoting *Freeport*, 180 U.S. at 600). The Court resolved the ambiguity in favor of the city.

A few unmistakability cases prior to *Home Telephone & Telegraph* did mention this sort of distinction between regulating and contracting, but none made it central to their reasoning. For example, the Court in *Rogers Park* noted that the ordinance used "the language of command, not of contract; of limitation on power, not a bargain giving power." *Rogers Park Water Co. v. Fergus*, 180 U.S. 624, 630 (1901). *Cf. Water, Light & Gas Co. v. Hutchinson*, 207 U.S. 385, 395 (holding that the state law authorized the city to contract away "the privilege of furnishing light for the streets . . . for any length of time not exceeding twenty-one years," but the Court held that this did not imply that such contracts would prevent the city from granting competing contracts during the twenty-one years). *Id.*

<sup>309</sup> *Keefe v. Clark*, 322 U.S. 393 (1944).

<sup>310</sup> *See id.* at 394-96.

[Michigan supreme court] declined to read into the statute . . . any purpose to permit drain districts to surrender the State's sovereign power to provide for the sale of tax-delinquent property free of encumbrances."<sup>311</sup> Next, the Court set forth a simple unmistakability rule: "settled principles of construction require that the obligation alleged to have been impaired to be clearly and unequivocally expressed."<sup>312</sup> This seems to refer to agreements with the bondholders. *Charles River Bridge* was also cited as authority for this rule.<sup>313</sup>

But in the next paragraph the Court again hints that the delegation issue is important by focusing on the authority to make the agreements on behalf of the state: "We do not find in the provision of the drain statute . . . a clear and unequivocal purpose of Michigan to permit drain districts to bargain away the State's power to sell tax-delinquent lands free of encumbrances."<sup>314</sup> The inconsistent analysis does not seriously undermine the Court's conclusions because the concerns protected by the two doctrines are so similar: leaving room for the legislature to change its regulatory policies while still allowing it to make binding agreements and at the same time locating accountability for making any promises that freeze regulatory policies. But *Keefe's* muddled reasoning may explain why it is seldom cited as either an unmistakability or express delegation doctrine case. In any event, its fact pattern, holding, and reasoning do show the strong logical connection between the two doctrines.

In *National Railroad Passenger Corp. v. Atchison, Topeka & Santa Fe Railway* ("AMTRAK"),<sup>315</sup> the Court employed analysis very similar to *Home Telephone & Telegraph* but, as in *Keefe*, it did not cite *Home Telephone & Telegraph*. In *AMTRAK*, the employees of other railroads sued AMTRAK after the federally chartered railroad stopped allowing them to ride on AMTRAK for free or reduced rates.<sup>316</sup> Like most railroad companies, the plaintiffs' employers had long contracted with AMTRAK for these prerequisites for their employees. In 1981, Congress completed a series of statutory changes that specifically required AMTRAK to charge the other railroads' employees.<sup>317</sup> The Court upheld the changes and relied

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<sup>311</sup> *Id.* at 396.

<sup>312</sup> *Id.* at 396-97.

<sup>313</sup> *See id.* at 397.

<sup>314</sup> *Id.*

<sup>315</sup> *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry.*, 470 U.S. 451 (1985).

<sup>316</sup> *See id.* at 456-57.

<sup>317</sup> *See id.* at 457.

on a rule that statutory language is presumed not to create contract rights: “absent an ‘adequate expression of an actual intent’ of the State to bind itself [citation omitted], this Court simply will not lightly construe that which is undoubtedly a scheme of public regulation to be, in addition, a private contract to which the State is a party.”<sup>318</sup> The Court then analyzed the specific wording of the legislation.

By its terms, the Act does not create or speak of a contract between the United States and the railroads, and it does not in any respect provide for the execution of a written contract *on behalf of the United States*. Quite the contrary, the Act expressly established the National Railroad Passenger Corporation as a nongovernmental entity, and it used the term “contract” not to define the relationship of the United States to the railroads, but instead that of the new, nongovernmental corporation to the railroads.<sup>319</sup>

The Court went on to distinguish *United States Trust* on the basis of the legislative language at issue there, which provided, in part, that the states “covenant[ed] and agree[d]”<sup>320</sup> with the bondholders. The Court went on to distinguish between the statute at issue in *AMTRAK* and the contracts entered into by the federally chartered company AMTRAK and the plaintiff railroads.<sup>321</sup> The statute created no contractual rights. Even though the reasoning in *AMTRAK* would seem to help with the threshold issue in *Winstar* of whether the regulatory approvals constituted contracts, the *Winstar* Court did not cite *AMTRAK*.

It could certainly be argued that the express delegation doctrine reads too much into the legislature’s wording of the statutes authorizing municipal regulation, but this criticism would also apply to the unmistakability doctrine, which invokes the same scrutiny to contractual language drafted by a governmental entity. Like the unmistakability doctrine, the express delegation doctrine aims to highlight whom to hold accountable for making regulatory agreements that are enforced against a city. State legislators must risk exposing themselves to some greater share of the blame when a city finds itself bound to unfavorable promises of

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<sup>318</sup> *Id.* at 466-67 (quoting *Wisconsin & Michigan R.R. v. Powers*, 191 U.S. 379, 386-87 (1903)).

<sup>319</sup> *Id.* at 467 (emphasis in original) (citation omitted).

<sup>320</sup> *Id.* at 469 (“Resort need not be had to a dictionary or case law to recognize the *language of contract*.”). *Id.* at 470 (emphasis added).

<sup>321</sup> *See id.* at 470-72.



long-term regulatory treatment. This makes sense because the legislators should not be encouraged to draft city charters and authorizing statutes that create traps for unwary city governments.

Without the express delegation, it is difficult to parse through whom to hold accountable in, for example, the *Sinking Fund Cases* of 1879.<sup>322</sup> In these companion cases, the Court upheld Congress's amendments to the federal statutes authorizing the government bonds that subsidized the transcontinental railroad companies which Congress had chartered at the same time it issued the bonds.<sup>323</sup> Without a theory of delegation, the Court could not respond effectively to one of the more powerful arguments made in the dissent of Justice Strong, who voted to strike down the amendments to the bond statute as a violation of contract. Strong asserted that the contract at issue appeared not in the federal statute, but in the bonds themselves.<sup>324</sup> Strong's argument begged the question of whether the governmental entity that drafted the language in the bonds did so with the authority to bind Congress to the promises made by the bond. Presumably, nameless bureaucrats at the Treasury were responsible for binding the United States to the bond contracts and, therefore, the Congressmen who enacted the original legislation bore less responsibility, if any. But this conclusion is only apparent when the analysis of the express delegation doctrine is superimposed upon the decision; Strong nowhere directly addresses who bears the blame for making the contracts, and neither the majority nor the dissenters analyze how their competing analyses would foster greater accountability in government contracts. By focusing on the issue of delegation, the express delegation doctrine locates responsibility more definitively with either the Congress—for passing the buck to the bureaucrats—or with the bureaucrats for agreeing to a bad contract, or both.

By treating the legislature and a city as separate contracting entities, decisions like *Home Telephone & Telegraph* and *AMTRAK* suggest an interpretation of municipal agreements that avoids seeing them as illusory promises even where the city lacks authority to bind the state. This second theme in the express delegation doctrine comes out expressly in *Southern*

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<sup>322</sup> *Union Pacific R.R. v. United States*, 99 U.S. 700 (1878) and *Central Pacific R.R. v. Gallatin*, 99 U.S. 727 (1878).

<sup>323</sup> See *Central Pacific R.R.*, 99 U.S. at 727.

<sup>324</sup> See *id.* at 732 (Strong, J., dissenting). This argument enabled Strong to avoid confronting the statutory language which included a reservation of congressional authority to amend the statute.

*Utilities v. Palatka*.<sup>325</sup> In *Southern Utilities*, a city sued a utility to prevent the utility from charging more than the rates agreed upon in the utility's charter. In an unusual twist, the city argued the charter was a contract, while the utility argued the contract was void for lack of mutuality.<sup>326</sup> The utility's mutuality argument hinged on the state's lurking "unfettered power . . . to regulate rates[.]"<sup>327</sup> despite the language in the charter. Justice Holmes rejected the lack of mutuality argument:

Without considering whether an agreement by the company in consideration of the grant of the franchise might not bind the company in some cases, even if it left the city free, *it is perfectly plain that the fact that the contract might be overruled by a higher power does not destroy its binding effect between the parties when it is left undisturbed*.<sup>328</sup>

Although *Southern Utilities* does not cite *Home Telephone & Telegraph* nor mention the express delegation doctrine, it does illustrate how the courts can avoid finding an illusory promise by distinguishing between the levels of government involved. This analysis from *Southern Utilities* dovetails nicely with the interpretive presumption employed by the express delegation doctrine: in the absence of expressly delegated authority to bind the state, a city may still bind itself, subject still to the unmistakability doctrine. Unfortunately, *Southern Utilities* appears to be the only example of the Court ratifying the notion that a city may enter into a regulatory agreement that binds the city even as it does not bind the state.<sup>329</sup>

The Supreme Court has not relied on *Home Telephone & Telegraph*, *Southern Utilities*, or the express delegation doctrine in cases involving contractual claims against the federal government. This seems unfortunate, because the issue of proper delegation of authority between the branches of the federal government takes on special importance in our modern administrative state. For example, when an agency of the federal government enters into a contract that binds Congress, the agency, as part of the executive branch, could improperly restrict the power of Congress

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<sup>325</sup> *Southern Util. v. Palatka*, 268 U.S. 232 (1925).

<sup>326</sup> *See id.* at 233.

<sup>327</sup> *Id.*

<sup>328</sup> *Id.* (emphasis added).

<sup>329</sup> *Cf. Mitchell, The Treatment of Public Contracts, supra* note 65, at 224-25 & n.145 (citing *Southern Utilities*, 268 U.S. at 233, but setting aside the delegation issue as beyond the scope of the Article).

to make new laws.<sup>330</sup> The interpretive presumption in the express delegation doctrine is perfectly suited to avoid this kind of encroachment. The Court in *AMTRAK* touches on the issue briefly:

The [plaintiffs] do not point to any language in [the original statute] authorizing Amtrak to *bargain away any portion of Congress' Commerce Clause power*, or to act as the Government's agent and confer upon the railroads the right to be free of any obligation to provide passenger service, assuming even that Congress could make that delegation.<sup>331</sup>

It makes sense, however, to apply the insight from *Southern Utilities* only to agencies of the government, not to federally chartered corporations, like AMTRAK, or the Union Pacific as in the *Sinking Fund Cases*.

The express delegation doctrine creates useful incentives for administrative agencies as well as cities. For a city to bind a state, not only must the legislature assume some responsibility for authorizing the city to do so, but the city itself would be on more explicit notice that its contracting decisions had better pan out in the long-run because they will share in the blame if they do not. In the absence of the express delegation doctrine, locating accountability for bad bargains assumes the difficulty now apparent in the *Sinking Fund Cases*. Applying the express delegation doctrine to federal agencies would clarify exactly which part of the government should be held to the contract. For example, an agency that makes an unmistakable agreement but which lacks delegated authority to bind Congress could be held to its promise by freezing its existing regulations without affecting Congress's power to repudiate the agreement by changing the underlying statutory authority. In the next section, I argue that the Court in *Winstar* could have done exactly that.

## 2. *The Updated Express Delegation Doctrine Should Have Shielded the Government from Liability in Winstar*

In order to clarify application of the express delegation doctrine, it is helpful to first analyze whether the agencies could claim an ultra vires

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<sup>330</sup> This concern probably becomes more acute when the remedy for the government's breach is an injunction blocking the new exercise of government power. But even where the remedy is damages paid by the government, the need to pay damages to pay for the right to change certain laws also limits congressional power. More on this later.

<sup>331</sup> *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry.*, 470 U.S. 451, 471 (1985) (emphasis added).

defense. Nowhere in the banking statutes do the agencies receive express authority to use goodwill in application of the capital requirements, but the authority is nonetheless sufficiently apparent to prevent the government from winning on an ultra vires defense because the ultra vires defense does not require unmistakable clarity. The FHLBB had authority to determine capital levels and what counted towards these requirements: “the Board shall require all associations to achieve and maintain adequate capital by—(A) establishing minimum levels of capital for associations[.]”<sup>332</sup> Several years after the FHLBB and FSLIC began relying on goodwill capital, Congress sanctioned the agencies’ interpretation of their authority to do so when it enacted the National Housing Act of 1987, part of which provided: “No provision of this section shall affect the authority of the [FSLIC] to authorize insured institutions to utilize subordinated debt and *goodwill* in meeting reserve and other regulatory requirements.”<sup>333</sup> The Senate Report included similar language: “It is expected . . . that the [Bank Board] will retain its own authority to determine . . . the components and level of capital to be required of FSLIC-insured institutions”<sup>334</sup> Given the deference typically accorded to federal agencies’ interpretations of the statutes they administer, it seems clear that the FHLBB and FSLIC did not exceed their authority by recognizing goodwill capital.

The express delegation doctrine analyzes a more specific question. To apply this defense, one scrutinizes the agencies’ statutes for the authority to enter into agreements that bind the government’s regulatory power. The statutes must authorize entering into an “agreement” or “contract,” not just “command” or “regulat[ion],” in the words of *Home Telephone & Telegraph*.<sup>335</sup> The FHLBB’s capital statute requires it to “establish” capital standards and “require” thrifts to meet those standards.<sup>336</sup> This is not a close call under the rule from *Home Telephone & Telegraph*.

This conclusion may seem unsatisfying because, much like the unmistakability doctrine, it might appear to give the government the power to make illusory promises. From the perspective of the private party, and

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<sup>332</sup> 12 U.S.C. § 1464(s)(1) (1988) (repealed). *See also id.* § 1464(s)(2) (the authority to establish individual capital levels exists on a case-by-case basis).

<sup>333</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 891 (1996) (quoting 12 U.S.C. § 1730h(d) (repealed 1989)) (emphasis added).

<sup>334</sup> *Id.* at 891 (quoting S. REP. NO. 100-19, at 55 (1987)).

<sup>335</sup> *Home Tel. & Tel. Co. v. Los Angeles*, 211 U.S. 265, 274-76 (1908).

<sup>336</sup> *See* 12 U.S.C. § 1464(s)(1) (1994).

under contractual reasoning, cases like *Rogers Park* and *Charles River Bridge* essentially require that, in order to bind the government entity to a regulatory agreement, the agreement must include language that government will not change its mind.<sup>337</sup> To the extent that the governmental party intends to lock in the specified regulatory treatment, it is a fair criticism that the unmistakability doctrine treats the government's promises as illusory.

The concerns driving the express delegation doctrine are answered equally well by applying its interpretive presumption to read the promises of government agencies as binding only the agency, not the sovereign legislature. *Southern Utilities* employs exactly this reasoning.<sup>338</sup> Under this view of the express delegation doctrine, the agreements in *Winstar* would bind the banking agencies but not Congress. This avoids the promises being read as simply illusory but also leaves Congress free to change the accounting rules used by the banking agencies without incurring contract liability for "the government." Indeed, this is probably the best reading of the reservation of authority in Statesman's agreement whereby Statesman agreed to "comply in all material respects with all applicable statutes, regulation, orders of, and restrictions imposed by the United States[.]"<sup>339</sup> This interpretation of the express delegation doctrine makes even more sense for federal agencies because the separation of powers would be undermined if executive branch agencies could restrict Congress's power to make new laws (even if the restrictions imposed took the form of creating liability for damage awards by passing new laws).

Accordingly, Glendale's and Statesman's agreements would not have bound the banking agencies because they did not provide unmistakable promises, within the holdings of the *Rogers Park* line of cases, that the government was bound. *Winstar*, however, would defeat the banking agency's unmistakability defense because its agreement provided that the specified accounting treatment (which recognized goodwill) would trump conflicting regulations. The agency is bound by its unmistakably clear agreement. But *Winstar* would lose under the express delegation doctrine, even though the same clause provided that the accounting treatment would

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<sup>337</sup> Souter, not unreasonably, refers to this as requiring the government to make a "second promise" to keep its first promise, though under the reasoning of the unmistakability cases, the ambiguity at issue is whether the government made the *first* promise by authorizing the private grantee to engage in whatever activities. See *Winstar*, 518 U.S. at 887. This is probably best understood as another example of the powerful rhetoric both sides have at their disposal in arguing these issues.

<sup>338</sup> See *Southern Util. v. Palatka*, 268 U.S. 232, 233 (1925).

<sup>339</sup> *Winstar*, 518 U.S. at 868.

trump conflicting *statutes*, because the agency did not have the authority to make a promise on behalf of Congress.<sup>340</sup>

This interpretation of the express delegation doctrine offers several advantages. It allows agencies to make binding regulatory promises without restricting congressional power to enact new laws. Analytically, *Home Telephone & Telegraph* helps reconcile many of the unmistakability cases. Even from within a purely contractual perspective limited to finding the intent of the parties, this interpretation makes sense because it more accurately identifies just who the governmental party is. Part II of this Article attempts to construct a unified theory of government defenses to contract liability for regulatory agreements. It is enough for now to recognize that the express delegation doctrine contains powerful, if latent, insights that do not deserve to be lightly dismissed.

### 3. *Souter's Summary Dismissal of the Express Delegation Doctrine*

The most persuasive interpretation of the agencies' promises is that they meant to govern the agencies' actions within their existing authority, but said nothing about actions by any other part of the government, such as Congress, over which the agencies had no control. This interpretation seems to most closely reflect the intention of the parties as it can be discerned from their agreements and the existing legal context. It also makes the most sense of the relevant pre-*Winstar* Supreme Court precedents. None of the majority's opinions explore this interpretation, however, perhaps because the government neither made such an argument nor cited *Southern Utilities* in its brief.<sup>341</sup>

Such an interpretation would alleviate Souter's legitimate concerns that it would have been "irrational" for the thrifts to accept illusory promises from the government. Souter raised this argument in construing the first of the three approvals, i.e., Glendale's:

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<sup>340</sup> This interpretation of the express delegation doctrine potentially allows for an improved balance between the goals of providing room for government to change the laws and protecting the reliance interests of private parties who have extracted promises from the government. In cases where the governmental body that makes the agreement is the same one that breaks it, as in *Charles River Bridge* and *POSSE*, the traditional unmistakability doctrine already strikes a good balance. Where a political subdivision or government agency makes a promise that is later broken by the sovereign body, a weaker interpretive presumption could suffice because the sovereign enjoys a second dimension of protection.

<sup>341</sup> See Petitioner's Brief, *United States v. Winstar Corp.*, 518 U.S. 839 (1996) (No. 95-865) (1996 WL 99716).

Although one can imagine cases in which the potential gain might induce a party to assume a substantial risk that the gain might be wiped out by a change in the law, it would have been irrational in this case for Glendale to stake its very existence upon continuation of current policies without seeking to embody those policies in some sort of contractual commitment. This conclusion is obvious from both the dollar amounts at stake and the regulators' proven propensity to make changes in the relevant requirements.<sup>342</sup>

The regulators' "propensity" refers, not inaccurately, to the agencies' track record of changing their regulations more often than they were required to by changes in their underlying statutory authority. Given the agencies' apparent lack of authority to bind Congress, at least under *Home Telephone & Telegraph* as it stood prior to *Winstar*, it is entirely possible, even likely, that the parties agreed that the agencies intended to bind only their own enforcement and promulgation of regulations. Nothing in the *Winstar* opinions explains why this reading would have been irrational or "madness."<sup>343</sup> In general, an interpretation predicated on avoiding "madness" fails upon discovery of any rational alternative interpretation.

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<sup>342</sup> *Winstar*, 518 U.S. at 863 (emphasis added). Justice Scalia, in his concurrence, makes a similar version of the same argument:

[Plaintiffs] say that the very *subject matter* of these agreements, an essential part of the *quid pro quo*, was Government regulation; unless the Government is bound *as to that regulation*, an aspect of the transactions that reasonably must be viewed as a *sine qua non* of their assent becomes illusory. I think they are correct.

*Id.* at 921 (emphasis in original). The illusory aspect of the promises disappears when one interprets the agreements as binding only the agencies.

<sup>343</sup> In his section on the Glendale approval, Souter cites *Binghamton Bridge*, which he summarizes as "refusing to construe charter in such a way that would have been 'madness' for private party to enter into it." *Id.* at 864. The Court in *Binghamton Bridge* makes a similar error of overreaching as well, for the state court in that case construed the charter's monopoly protection provision as binding only other private parties that might want to build a competing bridge; the charter need not have bound the state to have been a rational contract for the plaintiffs to agree. See *Binghamton Bridge*, 70 U.S. (3 Wall.) 51 (1865). One could argue in response that *Binghamton Bridge* got it right because competitors would have needed a charter to build a competing bridge anyway (perhaps because of state regulation of roads and highways), and so, the only effective protection from competition would have been one that limited the state's ability to grant competing bridge charters. But corporate charters were comparatively difficult to obtain at that

Instead, the plurality dismisses the express delegation doctrine by repeating its unmistakability analysis: because a promise to pay damages does not affect Congress's power to pass new laws, there is no reason to apply the express delegation defenses either because it too seeks to protect sovereign power to enact new laws. "*Home Telephone & Telegraph* simply has no application to the present case, because there were no contracts to surrender the Government's sovereign power to regulate."<sup>344</sup>

This analysis suffers the same flaws as those discussed above regarding the plurality's treatment of the unmistakability doctrine. It limits the express delegation doctrine's applicability to an extremely narrow type of case. It gives plaintiffs' attorneys easy ways to avoid the doctrine altogether even within that narrow category. It also fails to clarify whether its basis in the inherent attributes of sovereignty means that the decision reverses the state express delegation holdings, such as *Home Telephone & Telegraph*, and it fails to address the doctrinal inconsistencies that result from simply presuming that private contracting rules should govern regulatory approvals.<sup>345</sup>

The alternative interpretation proposed above would, however, create a subtle but difficult hurdle for the plurality's reliance on contractual analysis. The proposed interpretation recognizes the agencies as analytically distinct from the government as a whole, at least as far as suggested by *Southern Utilities*. Only when the distinction between an agency and the government is collapsed does the majority opinions' purely

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time, prior to the spread of general incorporation laws, and so forcing a competitor to obtain a charter could easily have provided enough monopoly protection to make the agreement reasonable for the private party to agree to. In any case, the response does not survive the advent of general incorporation laws and the concomitant use of other regulatory statutes, besides corporate charters, to regulate corporate activity. This practice is generally the rule even in banking, one of the few industries where regulatory restrictions are still sometimes imposed as part of the institution's charter.

<sup>344</sup> *Winstar*, 518 U.S. at 889-90.

<sup>345</sup> Moreover, one of the three regulatory agreements, *Winstar's*, seems to contradict Souter's "no surrender" interpretation because *Winstar's* approval agreement provided that if the agreement's recognition of goodwill contravened any regulations, the agreement would govern. Only under Souter's strained reading of "no surrender" does this make sense because the agency is left free to change the rule if it wants, despite the language in the approval (as long as the Treasury pays the necessary damages). Not surprisingly, Souter does not mention the odd incentive this could create if the damages are paid directly out of the Treasury and not the agency's budget.



contractual analysis make sense, for only then can the agency, as the governmental party, agree to make a promise to pay damages. Recognizing the separation of functions between the federal agencies, as part of the executive branch, and the Congress as the law-making arm of the government, raises the sort of concerns that are the province of administrative law—whether or not the agency has acted within its statutory authority. Recognition of the agency as a separate actor implies judicial review based on the Administrative Procedures Act. In addition to the more deferential review under the Administrative Procedures Act, however, is the different remedy: an injunction against the agency blocking the new regulation. The analytic step of recognizing the agency as a separate actor, then, leads to the conclusion that damages are not available. Damages for contract liability come into play, under the Tucker Act, only when the government makes promises. Whether an agency can make a promise on behalf of the government is precisely the question addressed by *Home Telephone & Telegraph* and avoided by *Winstar*.

A federal agency cannot bind the government to contract liability for damages unless it has authority to do so. In addition to ordinary ultra vires limitations on agencies is the Anti-Deficiency Act. A few months earlier in the same 1996 term, the Court decided *Hercules, Inc. v. United States*,<sup>346</sup> which denied a Tucker Act claim brought by manufacturers of Agent Orange. The manufacturers filed suit against the federal government just after they settled class action tort claims brought by victims of Agent Orange exposure. The manufacturers argued that their procurement contracts with the government included indemnification protection.<sup>347</sup> The Court relied on a long-standing rule that the government assumes liability for loss only if the government gave the contractor instructions on how to perform the contract and those directions cause the alleged harm.<sup>348</sup> Here, the manufacturers performed their government contracts without loss and there was no defect in the required manufacturing process. This rule, relied upon by *Hercules*, contrasts sharply with the *Winstar* plurality's broad reading of the guarantee against loss authority (discussed below).

Moreover, the *Hercules* Court held that the Anti-Deficiency Act prohibits open-ended indemnification for third party liability in government contracts unless there are appropriated funds to cover the liability.<sup>349</sup>

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<sup>346</sup> *Hercules, Inc. v. United States*, 516 U.S. 417 (1996).

<sup>347</sup> *See id.* at 421.

<sup>348</sup> *See id.* at 424 (citing *United States v. Spearin*, 248 U.S. 132 (1918)).

<sup>349</sup> The Court in *Hercules* held:

The Anti-Deficiency Act bars a federal employee or agency from entering

Congress appropriated no funds for this sort of contract liability and indeed is faced with daunting estimates of future appropriations in the tens of billions to cover *Winstar*-type claims.<sup>350</sup> The Act's requirement of appropriation of funds polices the inherent externality that would exist if agencies were allowed, by presumption or inherent powers, to create unlimited liabilities of the federal treasury. The Anti-Deficiency Act thus recognizes the distinct roles of the federal agencies—which make nearly all government contracts—and of the government as a whole.

Justice Rehnquist raises *Hercules* in his dissent, focusing on its distinction between implied-in-fact promises and implied-in-law promises. Implied-in-law promises are those where the contextual facts support the conclusion that the parties actually agreed to the disputed provision, but did not fully articulate it; implied-in-fact promises are actionable under the Tucker Act. Implied-in-law promises are essentially legally-imposed presumptions, and are not actionable under the Tucker Act.<sup>351</sup> All of this goes essentially unanswered by the majority opinions, which would be hard-pressed to explain why *Hercules* does not apply here.<sup>352</sup> In both *Hercules* and *Winstar*, the plaintiffs read the agreements as providing for government indemnification for actions beyond the control of the agency that made the promise: damage from latent defects in *Hercules*, and loss from a new statute in *Winstar*. If *Hercules* is distinguishable, it would seem that the strongest distinction is that the agreement in *Hercules* was a typical government procurement contract, not a regulatory agreement setting forth

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into a contract for future payment of money in advance of, or in excess of, an existing appropriation. 31 U.S.C. § 1341. Ordinarily no federal appropriation covers contractors' payments to third-party tort claimants in these circumstances, and the Comptroller General has repeatedly ruled that Government procurement agencies may not enter into the type of open-ended indemnity for third-party liability that petitioner Thompson claims to have implicitly received under the Agent Orange contracts. We view the Anti-Deficiency Act, and the contracting officer's presumed knowledge of its prohibition, as strong evidence that the officer would not have provided, in fact, the contractual indemnification Thompson claims.

*Id.* at 427-28 (footnotes omitted).

<sup>350</sup> See, e.g., Schmitt, *supra* note 15, at A12 (estimating *Winstar* liability at \$30 billion).

<sup>351</sup> See *Winstar*, 518 U.S. at 930.

<sup>352</sup> Cf. Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 496 (suggesting that Souter "bifurcated the Government into two juridical personalities: the Congress . . . and 'the Government'" but then criticizing this bifurcation for being inconsistent with Souter's sovereign acts analysis).

how regulatory power would be exercised. Such a distinction, however, would clearly undermine most of the majority's analysis, for surely damages should be harder to win against the government when it acts in its sovereign role than its contractual role.

The plurality does attempt to locate statutory authority for a promise to pay damages, but the attempt clearly does not satisfy *Hercules*. The only arguably applicable authority it can find for authority to pay damages is a provision that authorizes the FSLIC to "facilitate a merger or consolidation" of its thrifts by giving the acquiring thrift a "guarantee against loss by reason of its merging or consolidating with or assuming the liabilities and purchasing the assets of such insured institution in or in danger of default."<sup>353</sup> Souter implies that this guarantee against loss authorized the agencies' to make "risk-shifting" promises to reimburse the acquiring entities for losses from FIRREA's elimination of goodwill capital. Such an interpretation of the promises makes the agreements even more difficult to distinguish from the implied indemnification claim rejected by the Court in *Hercules*, because this reasoning says nothing about the intention of the parties. Such evidence is necessary for the provision to be implied-in-fact rather than implied-in-law.<sup>354</sup> Reliance on the agency's authority to provide a guarantee against loss also mistakes what the agency might have agreed to with what it intended to agree to. Souter's reasoning really says more about the breadth of the Holmesian presumption than it says about what the parties intended to require of each other.

Moreover, the breadth of this reading amounts to a presumption of the authority to contract. The statutory language does not specify how directly the merger must cause the loss: "loss by reason of its merging."<sup>355</sup> A typical guarantee against loss covers losses arising from certain, clearly defined business risks of taking over a failing thrift, for example that weaknesses in part of the target's loan portfolio were underestimated. None of the regulatory agreements in dispute here cited this authority for anything relating to the goodwill capital provisions. In order to conclude that the guarantee against loss includes loss from a change in the capital rules, the guarantee must be read so broadly that *any* losses would be covered if the

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<sup>353</sup> *Winstar*, 518 U.S. at 890 (quoting 12 U.S.C. § 1729(f)(2) (repealed 1989)) (emphasis added).

<sup>354</sup> Cf. Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 564 (suggesting that *Hercules* does not support application of the Holmesian presumption to an "indemnity agreement").

<sup>355</sup> *Winstar*, 518 U.S. at 890 (emphasis added).

losses would not have occurred *but for* the acquiring thrift acquisition of the target. Such “but for” causation is very broad. Indeed, the chartering of the target thrift would also meet the but for causation. To say the merger caused the loss in this context is better understood as simply another rendition of the Holmesian presumption that any agreement includes promises to pay damages (and that these agreements put the risk of congressional changes onto the government).

Further evidence that Souter is simply presuming the authority to bind the government contractually to pay damages appears in his citation of FSLIC’s authority “to make contracts.” The statute Souter cites refers to the agency’s general corporate powers,<sup>356</sup> and Souter’s accompanying footnote quotes a government contracting treatise for its argument that: “The authority of the executive to use contracts in carrying out authorized programs is . . . *generally assumed* in the absence of express statutory prohibitions or limitations.”<sup>357</sup> Another of Souter’s footnotes shows even greater signs of the analytic strain required to impose this presumption upon regulatory agreements.<sup>358</sup> After the sentence concluding that *Home Telephone & Telegraph* does not apply to damages provisions, Souter’s footnote quotes an article in which the author points out that governmental and private parties sometimes contract to compensate the private party for intervening acts of other governmental entities that render performance impossible.<sup>359</sup> Souter stretches the premise that the parties *may* agree to such compensation to the conclusion that the government *always* makes such promises.<sup>360</sup> This analysis of the guarantee against loss authority

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<sup>356</sup> See *id.* (citing 12 U.S.C. § 1725(c) (1988)).

<sup>357</sup> *Id.* at 890 n.36 (quoting 1 RALPH C. NASH & JOHN CIBINIC, FEDERAL PROCUREMENT LAW 5 (3d ed. 1977)) (emphasis added).

<sup>358</sup> See *id.* at 890 n.35.

<sup>359</sup> See *id.* (quoting Speidel, *supra* note 298, at 516).

<sup>360</sup> Cf. Speidel, *supra* note 298, at 535-47 (discussing agencies’ ability to assume the risk of breaches or delays caused by sovereign acts). Souter also cites *Hughes Communications Galaxy, Inc. v. United States*, 998 F.2d 953 (Fed. Cir. 1993) for support of the Holmesian presumption. See *Winstar*, 518 U.S. at 870 n.17. But this cite is somewhat disingenuous. The court in *Hughes Communications* rejected the government’s defense of the sovereign acts doctrine where delays in the space shuttle program caused NASA to miss its deadlines for launching private payloads. A launch scheduling policy specifically referenced in the contract provided: “Should events arise which require rescheduling, the U.S. will consult with all affected users in an attempt to meet the needs of the users in an equitable manner.” *Hughes Communications*, 998 F.2d at 956 (emphasis added). No Holmesian presumption was necessary or employed to reach the result in *Hughes*

makes it clear that the plurality wishes to completely reverse the presumption from *Home Telephone & Telegraph* and create a new rule that the authority of an agency to bind the Treasury to pay damages for breach of any promises made by the agency, no matter which part of the government causes the breach is presumed.

Ignoring the issues implicit in delegation of authority to the agencies is probably the fundamental flaw that runs throughout all of the opinions in *Winstar*. The Court's analysis skirts the key ambiguity of which arm of the government would drive the change in the regulations. Specifically, the Court does not address whether the agencies can issue new regulations, as they often have, or whether Congress can enact new underlying statutory authority and thereby require the agencies to issue new regulations. Note that this ambiguity, unlike the threshold issue in the unmistakability analysis above, exists even within a contractual perspective that looks only to the intent of the parties.

Souter distinguishes between the agencies and Congress only when it helps to clarify his reasoning that the agencies' purported promise to pay damages does not "ossify the law in conformity to the contracts"<sup>361</sup> or "constrain" Congress from passing contrary laws.<sup>362</sup> Souter, however, often refers to "the Government" as the contracting party, for example: "Nothing in the [regulatory approvals] purported to bar the *Government* from changing the way in which it regulated the thrift industry."<sup>363</sup> This seems implausible in light of the language of the *Winstar* approval.

Over and over again, Souter alludes to a delegation of authority only to the extent necessary to explain his rule of the case without hinting at the sorts of delegation issues raised by *Home Telephone & Telegraph* specifically or by administrative law generally.<sup>364</sup> Exploring the distinction

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*Communications*. See also *id.* at 959 n.9 (describing another example of the government expressly agreeing to compensate for damages from sovereign acts).

<sup>361</sup> *Winstar*, 518 U.S. at 871.

<sup>362</sup> See *id.*

<sup>363</sup> *Id.* at 868 (emphasis added).

<sup>364</sup> See *id.* at 864 (noting that the lower court correctly found that "the government had an express contractual obligation"). *Id.* For example, Souter dismisses the government's attempt to distinguish *Lynch* on the basis that the original contract took the form of a federal statute with "[p]utting aside the question why this distinction would make any difference." *Id.* at 885. Souter effectively glosses over the obvious implication that *Lynch* did not involve similar delegation issues because Congress made the original promise itself by enacting a statute. In another example, Souter discusses the American rule of legislative sovereignty and explains that it "has always lived in some tension with the

between the “Government,” Congress, and the agencies would have exposed the gap in the plurality’s reasoning which it bridges by presuming that an agency can make promises that bind the entire government, even if those promises are “merely” promises to pay damages.

Continuing its analysis of the express delegation doctrine, the *Winstar* plurality lays out what might appear at first glance to be an alternative holding that the agencies had authority under *Home Telephone & Telegraph* to make the regulatory contracts:

There is no question . . . that the Bank Board and FSLIC had ample statutory authority to do what the Court of Federal Claims and the Federal Circuit found they did do, that is, promise to permit respondents to count supervisory goodwill and capital credits toward regulatory capital and to pay respondents’ damages if that performance became impossible.<sup>365</sup>

By framing the issue as the authority to make “promise[s],” this language could be read as addressing *Home Telephone & Telegraph*’s concern for authority to contract regarding regulatory treatment, but upon closer examination it is clear that, notwithstanding these hints, the plurality’s express delegation analysis instead refutes only a more general ultra vires defense. First, the opinion refers to the express delegation doctrine and the reserved powers doctrine as the government’s “two related contentions of the score of ultra vires.”<sup>366</sup> Second, Souter’s analysis of the agency’s

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constitutionally created potential for a legislature, under certain circumstances, to place effective limits on its successors, or to *authorize executive action resulting in such a limitation.*” *Id.* at 873 (emphasis added). The delegation issue implicit in the last clause is then dropped and ignored. Also, Souter agrees with lower court’s interpretation that “the Bank Board and the FSLIC were contractually bound. . . . We read this promise as the law of contracts has always treated *promises to provide something beyond the promisor’s control*, that is, as a promise to insure the promisee against loss arising from the promised condition’s nonoccurrence.” *Id.* at 868 (emphasis added). Souter does not pursue the obvious implication that the regulatory change is only beyond the agency’s control if driven by legislation. Regulatory change via new regulations should be within the agency’s control, so why would the agency agree to promises broader than that? Unfortunately, none of the other decisions, including the dissent, criticize this aspect of Souter’s opinion.

<sup>365</sup> *Id.* at 890.

<sup>366</sup> *Id.* at 888. The government’s brief in *Winstar* did little to discourage this treatment of the express delegation doctrine. It combined the reserved powers doctrine and the express delegation doctrine into its second section (out of three), entitled: “The Relevant Federal Agencies Had No Authority to Bind Their

statutory authority to “make contracts”<sup>367</sup> does not satisfy the exacting standard from *Home Telephone & Telegraph*, nor does Souter analyze the appropriate statute—12 U.S.C. § 1464—which authorized the FHLBB to “establish” minimum capital levels.<sup>368</sup> This section only makes sense as an ultra vires analysis, because Souter simply presumes the agency had the power to make the damages promise, citing a government contracting treatise for its argument that, “[t]he authority of the executive to use contracts in carrying out authorized programs is . . . generally assumed in the absence of express statutory prohibitions or limitations.”<sup>369</sup> This presumption, however, is precisely the difference between the express delegation doctrine and the traditional ultra vires rule.

By ignoring both the issue of administrative delegation and the Anti-Deficiency Act, the *Winstar* majority creates an unwisely open-ended (and apparently retroactive) regime of governmental liability for damages for any statutory change in regulatory treatment of any activity permitted by any prior approval, license, or grant. *Winstar* also makes it extremely difficult for agencies to enter into agreements governing agencies’ use of discretion to write and enforce regulations. Although the most plausible interpretation of the agreements is that the parties intended to limit the agencies’ freedom of action within their statutory framework, agencies may now do so only at the risk of creating broad liability for damages for the Treasury, should Congress change that statutory framework.

### E. *The Sovereign Acts Doctrine*

Justice Souter goes to even greater lengths to avoid recognizing any difference between the regulatory agreements and typical procurement

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Successors to Particular Regulatory Policies Despite Subsequent Legislative Changes.” Petitioner’s Brief at \*3, *United States v. Winstar Corp.*, 518 U.S. 839 (1996) (No. 95-865) (1996 WL 99716). As this heading suggests, this section argued that attempting to bind either a successor agency or Congress would have been ultra vires for the FHLBB. The reserved powers and express delegation doctrines differ importantly in that reserved powers analyzes a sovereign’s power to bind *itself* while the express delegation doctrine focuses on a subordinate governmental unit’s authority to bind its superior sovereign body. Combining these two arguments into the same section obscured the distinction. Instead of arguing that the agencies’ promises bound only the agencies, the government’s brief also essentially admits that the government viewed the banking agencies’ promises as illusory, good only as long as the government cared to honor them.

<sup>367</sup> *Winstar*, 518 U.S. at 890 (quoting 12 U.S.C. § 1725(c) (1988) (repealed 1989)).

<sup>368</sup> 12 U.S.C. § 1464(s)(2) (repealed 1994).

<sup>369</sup> *Winstar*, 518 U.S. at 890 n.36 (quoting NASH & CIBINIC, *supra* note 357).

contracts in his analysis of the sovereign acts doctrine. The sovereign acts doctrine provides a defense for the government to contract liability when the government's performance is blocked by the action of a broad new provision of law. Just how broad the new law must be has always been open to some debate, but under the better reading of the doctrine, the elimination of goodwill under FIRREA is probably not broad enough to provide a defense. This begs the question of why Souter works so hard to avoid a straight-forward application of the doctrine.

### 1. *Origins and Critique of the Sovereign Acts Doctrine*

The sovereign acts doctrine traces back to two early decisions of the Court of Claims, in cases arising from Civil War-era procurement contracts. In *Deming v. United States*,<sup>370</sup> the plaintiffs had contracted to provide food for the Marines. Congress then imposed a duty on some of the covered items, and the plaintiffs consequently suffered losses in fulfilling the contracts. The plaintiffs again contracted to provide food, only to have Congress pass the Legal Tender Act, which again raised prices of some of the inputs and the plaintiffs suffered losses in fulfilling the second contract. The court held there was no government liability for the losses:

A contract between the government and a private party cannot be *especially* affected by the enactment of a *general* law. The statute bears upon it as it bears upon all similar contracts between citizens, and affects it in no other way. In form, the claimant brings this action against the United States for imposing new conditions upon his contract; in fact he brings it for exercising their sovereign right of enacting laws. But the government entering into a contract, stands not in the attitude of the government exercising its sovereign power of providing laws for the welfare of the State. The United States as a contractor are not responsible for the United States as a lawgiver.<sup>371</sup>

*Deming* thus announces the two analytical halves of the sovereign acts doctrine. First, the government acts in one of two roles: that of a sovereign with power to regulate its citizens and their corporations, or that of a contracting party that sheds its sovereignty and chooses instead to enter into a contractual relationship with private parties. Second, in order to ensure that the subsequent act of the government (i.e., the act that comes

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<sup>370</sup> *Deming v. United States*, 1 Ct. Cl. 190 (1865).

<sup>371</sup> *Id.* at 191 (emphasis added).



after the contract and causes its breach) is not simply an attempt by the contracting part of the government to renege on its contract, the courts will require that the subsequent act not be targeted at the specific contract, but instead have a “general” intention and effect.

Similarly in *Jones v. United States*,<sup>372</sup> plaintiffs had contracted to perform surveying of Indian lands covered by certain treaties. Plaintiffs’ performance was delayed, however, when the army withdrew its protection from the sector.<sup>373</sup> Plaintiffs sued for losses from “obstructions and hindrances” caused by the government’s actions, but the court rejected the claim:

The “obstructions and hindrances” complained of on the part of the United States were the withdrawal of their troops from the military posts in the Indian country, contrary to the terms of the Indian treaties; and it is insisted, “as a matter of law,” that “the United States could not change their attitude or their policy in a material degree, without incurring the responsibility of making the claimants just compensation for all additional expenses thereby incurred.”

This position cannot be sustained. The two characters which the government possesses as a contractor and as a sovereign cannot be thus fused; nor can the United States while sued in the one character be made liable in damages for their acts done in the other. Whatever acts the government may do, be they legislative or executive, so long as they be *public and general*, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons.<sup>374</sup>

*Jones* slightly rewrites the test from *Deming* to read “public and general,” but the concept is clearly the same.

Two aspects of *Jones* are notable. First, *Jones* extends the sovereign acts doctrine to “executive” action of the government, not just subsequent legislation that causes breach of the original contract.<sup>375</sup> Second, *Jones* goes further than *Deming* to explain that the government gets treated as any other contractor, but only when it has chosen to shed its sovereign role and assume the role of private contractor.

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<sup>372</sup> *Jones v. United States*, 1 Ct. Cl. 383 (1865).

<sup>373</sup> *See id.* at 384.

<sup>374</sup> *Id.* (emphasis added).

<sup>375</sup> *See id.*

In this court the United States appear simply as contractors; and they are to be held liable only within the same limits that any other defendant would be in any other court. Though their sovereign acts performed for the general good may work injury to some private contractors, such parties gain nothing by having the United States as their defendants. Wherever the public and private acts of the government seem to commingle, a citizen or corporate body must by supposition be substituted in its place, and then the question be determined whether the action will lie against the supposed defendant. . . . This distinction between the public acts and private contracts of the government—not always strictly insisted on in the earlier days of this court—frequently misapprehended in public bodies, and constantly lost sight of by suitors who come before us, we now desire to make so broad and distinct that hereafter the two cannot be confounded; and we repeat, as a principle applicable to all cases, that the United States as a contractor cannot be held liable directly or indirectly for the public acts of the United States as a sovereign.<sup>376</sup>

*Jones* does not stand for the proposition that whenever the government makes an agreement of any kind the government is to be treated as a private contracting party, because the analysis includes a strong distinction between the sovereign and private roles of the government.

Having made this distinction, however, *Deming* and *Jones* are essentially silent on how to treat an agreement made by the government in its *sovereign* capacity. It is clear from the opinions that the court means to deny the private plaintiffs the advantage of holding up the actions of one part of the government as violative of an agreement made by another part of the government. One could reasonably guess that if the government made promises in a sovereign capacity, and subsequent sovereign acts of the government breached that agreement, *Deming* and *Jones* would not allow the government to use the special defense of the sovereign acts doctrine because in such a case it is the same part, or role, of the government both making and breaking the promise. In that case, the unmistakability and express delegation doctrines by themselves might provide the best balance between the competing goals of protecting individuals' contract rights and preserving freedom of action by the government. On the other hand, if the subsequent, breaching act was much broader and more general than the original promise, or the subsequent act was unequivocally caused by another arm of the government, the doctrine could still apply. *Deming* and *Jones* simply do not provide much clue.

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<sup>376</sup> *Id.* at 384-85.

The Supreme Court put its stamp of approval on the sovereign acts doctrine in *Horowitz v. United States*, decided in 1925.<sup>377</sup> The plaintiff agreed to purchase war surplus silk, at an agreed-upon price, from the Ordinance Department's New York Ordinance Salvage Board. Under the terms of the contract, the Board promised to ship the silk within two days to a third party, to whom plaintiff planned to sell the silk at the market price. The Board shipped the silk almost a month late due to an embargo on domestic shipment of silk imposed by the Railroad Administration just after execution of the contract. During the embargo, the price of silk plummeted and plaintiff suffered consequential damages.<sup>378</sup> The Court held that there was no liability on the contract with the Board. The Court quoted much of the language above from *Jones*, adding simply: "We think this was correct[.]"<sup>379</sup>

Though the Supreme Court has not often revisited the doctrine, the lower courts have relied upon it on numerous occasions.<sup>380</sup> Professor Speidel thoroughly analyzed the courts' application of the doctrine in cases where an agency made the original contract and another agency performed the subsequent sovereign act that caused the breach. The cases he discusses, like *Deming* and *Jones*, are limited to situations where the original contract was made by the government agency acting in its proprietary capacity.<sup>381</sup> Speidel does not discuss cases involving regulatory agreements, but he does argue that the sovereign acts doctrine necessarily includes a requirement that the government assumes an implied duty of cooperation with the private contractor. This duty is limited, however, to the particular agency that makes the contract, not the government as a whole. In an example where agency X makes a contract which becomes impossible to perform due to the sovereign acts of agency Y, Speidel would disallow the defense if agency X knew of the conditions about to be imposed by agency Y and did not inform the private party in advance. Speidel discusses several, more complicated examples as well, but for our purposes the point remains the same: government agencies are viewed as

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<sup>377</sup> *Horowitz v. United States*, 267 U.S. 458 (1925).

<sup>378</sup> *See id.* at 459-60.

<sup>379</sup> *Id.* at 461.

<sup>380</sup> *See, e.g.*, Krent, *supra* note 165, at 1558-61 (arguing that courts have applied the doctrine consistently); Peter S. Latham, *The Sovereign Act Doctrine in the Law of Government Contracts: A Critique and Analysis*, 7 U. TOL. L. REV. 29 (1975) (analyzing numerous cases); Speidel, *supra* note 298, at 516.

<sup>381</sup> *See* Speidel, *supra* note 298, at 532-35 and 540-47.

separate contracting entities.<sup>382</sup> Speidel adds the interesting note that, at least in cases where two separate agencies are involved, the subsequent sovereign act must cause the breach only indirectly if the government is to succeed with the sovereign acts defense.<sup>383</sup>

Speidel also aptly summarizes three rationales behind the sovereign acts doctrine. First is the need to separate the actions of different agencies.<sup>384</sup> Second, “[a]ny court-established rule imposing a blanket liability upon the United States for non-contractual acts of effective government would place an intolerable burden on the public treasury.”<sup>385</sup> Third, the doctrine prevents private contractors from having an advantage they would not have if the contracting agency were in fact a private party that had to contend with sovereign acts just like any other private party.<sup>386</sup> This third rationale, which seems to attract universal agreement, is the genius of the sovereign acts doctrine because it comprehends the government acting in its two distinct roles, rather than simply trying to view government agreements as always different or always the same as private contracts. Thus, it has the potential to reconcile the logic of exceptionalism and congruence by showing when each is appropriate.

Attempts to clarify or refine the sovereign acts doctrine’s standard for liability, however, reveal the doctrine’s potential weaknesses. First, its relation to the unmistakability and express delegation doctrines has never been thoroughly analyzed, either by courts or commentators. For example, Professor Latham, in his analysis of the sovereign acts doctrine, proposes a three-part test that attempts to tie in takings analysis and look closely at the nature of the original promise.<sup>387</sup> But the unmistakability doctrine focuses on the nature of the original promise, and *Jones, Deming*, and *Horowitz* all seem to presume the enforceability of the original contracts, so what does it add to look there? Since the sovereign acts doctrine focuses on the *subsequent* sovereign act, attempts to analyze the original promise at the same time are confusing, especially if they do not discuss the role

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<sup>382</sup> See *id.* at 542-43. See also *id.* at 545 (discussing *Derecktor v. United States*, 128 F. Supp. 136 (1954), cert. granted, 348 U.S. 926, dismissed per stipulation, 350 U.S. 802 (1955)).

<sup>383</sup> See *id.* at 540.

<sup>384</sup> See *id.* at 538-39. Speidel favorably cites Mitchell, *A General Theory*, *supra* note 286, at 60, for this rationale.

<sup>385</sup> Speidel, *supra* note 298, at 539.

<sup>386</sup> See *id.* at 539. See also Latham, *supra* note 380, at 37-39 (summarizing similar rationales, but offering a different critique).

<sup>387</sup> See Latham, *supra* note 380, at 57.

remaining for the unmistakability and express delegation doctrines. The confusion arises from the fact that such a mixed analysis tends to blur the government's two roles, while still trying to affirm the logic of *Jones*. Part II discusses the relationship between these three doctrines in more depth.

The second ambiguity in the sovereign acts doctrine is simply defining the threshold for how public and general the subsequent act needs to be for the government to avoid liability. In *Deming*, the public at large felt the effects of the Legal Tender Act, even though the plaintiffs felt a more particularized harm from the resulting rise in prices for inputs necessary to fulfill the contract.<sup>388</sup> In *Jones*, all non-Indians in the area from which the army withdrew presumably suffered the absence of its protection, but the plaintiffs had a particular contract that was hindered.<sup>389</sup> In *Horowitz*, all persons needing to ship silk suffered from the embargo, but the plaintiffs had a particular, unfortunately-timed contract to fulfill.<sup>390</sup>

In each case, there are two dimensions to the scope of the new sovereign act. Initially, it is helpful to compare how many people the new act affects generally with how many people have contracts particularly affected. Then, for those with contracts affected by the new sovereign act, how direct and serious is the effect. *Horowitz* seems to present the closest call of the three cases, but it is difficult to tell precisely because the reported opinion provides so few facts. For example, in the post-war market for silk, it is certainly conceivable that government surplus was a major supplier; if that were the case, most shippers in the Northeast might have bought silk from the government's New York Ordinance Salvage Board. Moreover, it is left unsaid whether the embargo affected only silk—the embargo was imposed by the Railroad Administration, not the Salvage Board. It is difficult, therefore, to test whether the Surplus Board and the Railroad Administration acted independently. Thus, even with the aid of Speidel's analysis, it is difficult to define the extent of the divergence between the scope of the new sovereign act and the number of contracting parties. In light of this, *Horowitz* seems to set a low standard for "public and general."

Professor Schwartz succinctly discusses the various possibilities for the level of generality within a working theory for the sovereign acts doctrine.<sup>391</sup> For example, Schwartz defines "complete" generality as resulting from a subsequent sovereign act that affects all citizens in the

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<sup>388</sup> See *Deming v. United States*, 1 Ct. Cl. 190, 190-91 (1865).

<sup>389</sup> See *Jones v. United States*, 1 Ct. Cl. 383, 384 (1865).

<sup>390</sup> See *Horowitz v. United States*, 267 U.S. 458, 460 (1925).

<sup>391</sup> See Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 633.

same manner as the plaintiffs.<sup>392</sup> Several generally conservative commentators have suggested importing takings analysis as a way to address the generality issue.<sup>393</sup> From a certain analytic distance, this approach has intuitive appeal, because one of the more widely accepted goals of takings is to prevent the singling out of a few individuals “to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”<sup>394</sup> Takings law thus struggles with the similar question of when the group that bears the burden becomes large enough that it is no longer being singled out. But given the abundant doctrinal difficulties and philosophical differences in takings law, it seems an imprudent place to look for theoretical guidance. It is important, nevertheless, to keep takings law in mind so as not to create a scheme under the sovereign acts doctrine that has wildly different rules or standards than takings law. It is not terribly difficult to present cases like *Winstar* as takings cases, or to present certain takings cases as regulatory contract cases. Therefore, different standards in the respective areas of law would inevitably tend to create pressure to define a case as one or the other. It is almost always more productive to argue directly about the liability rules than to argue about the more abstract—and more arbitrary—definitions of terms or claims.

A few liberal commentators have suggested political process theory as a measure for the level of generality appropriate under the sovereign acts doctrine.<sup>395</sup> Political process theory, appropriately attributed to the work of

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<sup>392</sup> Schwartz’s summary of the various issues provides a thorough and intelligent grounding of the issues presented when regulatory agreements are analyzed as contracts. Schwartz’s proposed test for liability adds little to his analysis, however, as it simply combines the issues into a list of elements to consider. This proposal, similar to Latham’s, does not explain how the sovereign acts doctrine differs from the unmistakability and express delegation doctrines or how they ought to interact doctrinally.

<sup>393</sup> See Latham, *supra* note 380; Michael L. Zigler, *Takings Law and the Contract Clause: A Takings Law Approach to Legislative Modifications of Public Contracts*, 36 STAN. L. REV. 1447 (1984); cf. J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851 (1996) (arguing that deregulation can work a taking by erasing a promised monopoly); Oliver E. Williamson, *Deregulatory Takings and Breach of the Regulatory Contract: Some Precautions*, 71 N.Y.U. L. REV. 1007 (1996).

<sup>394</sup> *United States v. Armstrong*, 364 U.S. 40, 49 (1960).

<sup>395</sup> See, e.g., Griffith, *supra* note 43, at 277 (suggesting a requirement that enforceable government contracts not undermine the political process); Krent, *supra* note 165, at 1564, 1576-77 (suggesting the political process analysis helps justify sovereign immunity); Sterk, *supra* note 43, at 702-18; Levy, *supra* note 130,

John Hart Ely,<sup>396</sup> advocates leaving most constitutional decisions to the political branches on the reasonable assumption that few constitutional issues are purely legal. Therefore, courts should generally defer to the legislature's view on most constitutional issues. The only exceptions would be for those issues that affect the political branches' decision-making processes. Courts already closely scrutinize legislation that affects individuals' rights to participate in the political process, with voting and speech rights as examples. Probably the first explication of such a theory to appear in a Supreme Court decision is the famous footnote in *Carolene Products*,<sup>397</sup> which provided for increased judicial scrutiny of legislation targeted at "discrete and insular"<sup>398</sup> minorities. If a group is too small or otherwise too powerless to have any reasonable input in the political process, it deserves special protection from the courts. Larger, more powerful groups are left to fend for themselves in the political branches.

A similar analytic approach would make sense in interpreting the sovereign acts doctrine. Groups that are large and/or politically powerful enough to have reasonable influence over the legislative process should be able to protect their contractual interests when those interests are threatened by subsequent legislation. After all, new legislation and regulation will often affect the contract rights of those who have agreements with the government. For example, Social Security benefits could conceivably be thought of as a contract, but when benefits are rolled back, the class of persons affected is so large that it is not thought to have a cognizable contracts claim against the government. As is probably apparent by now, political process theory, for all its theoretical appeal, does little to suggest a workable standard for how large the affected group must be for the legislation to be public and general. Perhaps the best lesson does come from takings law: try to use comparisons of the facts from certain cases. In this vein, the affected group would not need to be anywhere near as large as Professor Schwartz's "complete generality" to satisfy the fact-based standard apparent in *Horowitz*, for the simple reason that very few people

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at 329; Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 656 n.122 (citing Saul Levmore, *Just Compensation and Just Politics*, 22 CONN. L. REV. 285 (1990) (suggesting the political process analysis in takings cases)); Note, *A Process-Oriented Approach to the Contract Clause*, 89 YALE L.J. 1623, 1647-50 (1979) (suggesting a variation on the political process theory as applicable to the Contracts Clause analysis).

<sup>396</sup> See JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW* (1980).

<sup>397</sup> *United States v. Carolene Prods. Co.*, 304 U.S. 144, 152-53 n.4 (1938).

<sup>398</sup> *Id.* at 153 n.4.

were affected by the silk embargo. Fortunately, the takings cases seem to deny compensation in situations where the number of persons affected by the legislation is roughly analogous to *Horowitz*.<sup>399</sup> In any event, the affected group needs to be large enough to avoid the conclusion that it is being singled out or that the government is using its sovereign power to relieve itself of an obligation it made earlier in its proprietary capacity.

## 2. *The Sovereign Acts Doctrine Should Have Been an Easy Loser for the Government in Winstar*

Since there is no clear choice for a standard, the outcome could not be certain, and the pre-*Winstar* commentary was split on whether the government would prevail on a sovereign acts defense.<sup>400</sup> The sovereign acts doctrine analyzes the subsequent sovereign act, which in this case was the provisions in FIRREA affecting goodwill capital. Among the many changes it made to the banking regulatory structure, FIRREA set strict, explicit capital requirements applicable to all thrifts. The OTS, successor to the abolished FHLBB, would now have little leeway in setting minimum standards. More importantly, “unidentifiable intangible assets” were expressly not to be counted towards capital.<sup>401</sup> The OTS quickly decided that FIRREA left it no option but to eliminate the goodwill capital that it had allowed hundreds of recently combined thrifts to carry on their books.<sup>402</sup> It promulgated regulations in conformity with its interpretation of

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<sup>399</sup> See, e.g., *Penn Cent. Transp. Co. v. New York*, 438 U.S. 104 (1978) (finding no taking in building restrictions placed on sites designated by the city as historic landmarks). It might be an interesting study to look for class-action takings cases to see whether any such cases have succeeded, and if so, how they have overcome the singling out language in cases like *Armstrong*.

<sup>400</sup> Compare Krent, *supra* note 165, at 1570 (arguing the government should succeed with a sovereign acts defense for FIRREA); and David Toscano, Note, *Forbearance Agreements: Invalid Contracts for the Surrender of Sovereignty*, 92 COLUM. L. REV. 426 (1992) (contending the government should not be liable); with Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 518 (suggesting FIRREA is not public and general); Linda B. Coe, *Abrogation of Forbearance Agreements: Unauthorized by FIRREA and Unconstitutional*, 59 GEO. WASH. L. REV. 157 (1990) (arguing the government should be liable).

<sup>401</sup> See 12 U.S.C. § 1464(t)(9)(A) (1994).

<sup>402</sup> But see Coe, *supra* note 400, at 159-73 (arguing that FIRREA required the OTS to recognize goodwill capital, not abrogate it). It is interesting to speculate on how things might have played out had OTS continued to recognize the goodwill capital. Certainly, the legal challenges to this action would have taken on an



FIRREA and informed thrifts not to count goodwill,<sup>403</sup> and soon began closing thrifts that were not in compliance with the new capital rules.

The capital provisions in FIRREA applied to all federally regulated thrifts, not just those with regulatory goodwill on their books. The difference in scope of these two groups is probably large enough to satisfy a factual comparison to *Horowitz* and *Jones*, and even to the takings cases. But, for those with no regulatory goodwill on their books, the new capital definition made no significant difference, unlike the other silk shippers that had contracted with non-governmental parties but who were nevertheless affected by the silk embargo. So it is largely semantics to argue that the new sovereign act *applied* to a larger group than those directly affected. It applied to a larger group but had a significant impact only on those thrifts with regulatory goodwill. Similarly, if one applies Speidel's requirement that, for the government to prevail, the effect must be indirect, it is clear that the affected thrifts suffered very directly as a result. Even a simple application of the sovereign acts doctrine, then, should lead to the conclusion that the government would not prevail on this basis.<sup>404</sup>

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entirely different tenor since it would presumably have been up to competing thrifts that did not have goodwill capital to sue the OTS on an APA claim. If the OTS had lost such a suit, it might have been in much better position to defend the *Winstar* action later for then it would appear as an agency that had tried to keep its predecessor's promises. Of course, such a policy undoubtedly would have drawn harsh criticism from members of Congress who expected OTS to abrogate the goodwill capital as a result of FIRREA.

<sup>403</sup> See OTS Thrift Bulletin 38-2 (Jan. 9, 1990) (notifying thrifts that goodwill should no longer be counted). There was a phase-in for the new capital rules, but the period was much shorter than the typical amortization schedule for goodwill that many of these thrifts had been given as part of the regulatory approval of their mergers. See 12 U.S.C. § 1464(t)(3)(A) (1994).

<sup>404</sup> The government's argument in its *Winstar* brief has no credible response to this logic. "FIRREA as a whole is plainly a 'public and general' statute. It instituted a comprehensive overhaul of the regulation of the entire thrift industry, for the protection of depositors nationwide and in order to promote the general welfare." Petitioner's Brief at \*44, *United States v. Winstar Corp.*, 518 U.S. 839 (1996) (No. 95-865) (1996 WL 99716) (emphasis added). This argument would plainly apply to very nearly every piece of legislation Congress enacted. The brief then gives a similar, if slightly more sophisticated, version of the first argument by suggesting that the proper standard "is not whether a particular party is affected by the governmental action at issue; it is whether the impact on a particular party or parties is caused by a law enacted to govern regulatory policy and to advance the general welfare." *Id.* (emphasis added).

Further analysis seems to confirm the point. Both the original agreements and the subsequent sovereign act were done in the government's sovereign role. The sovereign acts doctrine recognizes that the government often takes sovereign or regulatory actions without any intention of affecting the contracts other arms of the government have made in a proprietary capacity. The defense is designed to ensure that actions undertaken in the sovereign role are not used as an indirect way of rescinding bad bargains made in the proprietary role. But here both the original agreement and the subsequent breaching act were done by the same, sovereign role side of the government.

Indeed, the legislative history could not be clearer that Congress specifically targeted the goodwill capital provisions and purposefully set out to revoke the regulator's recognition of goodwill. Proponents of FIRREA's capital provisions argued that it would produce a necessary culling of the weak thrifts and ultimately reduce the total cleanup bill by keeping small problems from becoming large and large problems from becoming catastrophic.<sup>405</sup> In this way, FIRREA vetoed the thrift regulators' strategy of hoping stronger thrifts could help weaker ones grow out of their problems. Opponents specifically pointed to the regulatory approvals as contracts and argued that FIRREA's new capital provisions would result in governmental breach of these contracts.<sup>406</sup> Proponents were less heated in responding to the concern about breach. Representative Saxton, for example, argued that "two wrongs don't make a right."<sup>407</sup> Representative Rostenkowski commented vaguely that the goodwill agreements were "not contracts written in stone."<sup>408</sup> As to the question of whether FIRREA's capital provisions would in fact cause the breach of the goodwill agreements, there seems to have been little real debate in Congress. The conclusion seems inescapable that Congress intended to target those thrifts that had entered into regulatory goodwill agreements with regulators.<sup>409</sup>

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<sup>405</sup> See, e.g., *United States v. Winstar Corp.*, 518 U.S. 839-901 (1996) (quoting 135 CONG. REC. 2703-01 (June 15, 1989) (statement of Rep. Rostenkowski)).

<sup>406</sup> See, e.g., *Winstar*, 518 U.S. at 900-02 nn.48-49.

<sup>407</sup> 135 CONG. REC. H2553-02 (June 14, 1989) (statement of Rep. Saxton).

<sup>408</sup> *Winstar*, 518 U.S. at 902 (quoting 135 CONG. REC. H2703-1, H2717 (June 15, 1989) (statement of Rep. Rostenkowski)).

<sup>409</sup> Despite this intentional targeting FIRREA's capital provision probably does not qualify as "singling out" as that term is used in takings analysis because the group of affected thrifts seems fairly large, especially, for example, in comparison to the group of building owners affected by the New York City historic preservation ordinance in *Penn Central Transportation Co. v. New York*. See *Penn Cent. Transp. Co. v. New York*, 438 U.S. 104 (1978).

If the sovereign acts doctrine deserved any special attention in *Winstar*, it could have been as a chance for the Court to clarify the standard for how broad the new sovereign act's effect must be. As we have seen in the discussion here on political process theory and elsewhere on takings, this would have been a sizeable undertaking, of course. A less ambitious, but still useful, endeavor might have been to elucidate one or two factors in addition to the scope of the new rule, such as Speidel's requirement that the effect of the new rule be indirect, or even a congressional intent element that, in order for the government to succeed, it must show that Congress did not directly intend or plan that the primary goal of the legislation was to breach existing regulatory agreements. Adding these elements to the sovereign acts doctrine would not have required an extended analysis or run counter to anything in *Horowitz*.

### 3. *The Likely Purpose Behind Souter's Lengthy Treatment of the Sovereign Acts Doctrine*

The plurality in *Winstar* took a much different—and greatly extended—path to its conclusion that the government could not prevail on the basis of the sovereign acts doctrine. Souter's analysis comes in three main parts. First, he makes two preliminary arguments that, upon closer scrutiny, might explain the reasons behind his approach. The second part lays out his view on the standard for public and general, which perfectly consistent with the traditional standard described above. Third, Souter argues at length that the sovereign acts doctrine also requires that the government prevail on the common law contracts doctrine of impossibility. When analyzed in the context of Souter's earlier arguments regarding the unmistakability and express delegation doctrines, it becomes clear that this extended exegesis is necessary in order for *Winstar* to both achieve internal logical consistency and provide damages remedies equivalent to a regulatory takings theory.

Souter gives his interpretation of the appropriate standard in the second part of his analysis. In isolation from the other parts of his opinion, it seems mostly consistent with *Horowitz*. Souter describes the sovereign acts doctrine as aimed at ferreting out legislation "tainted by a governmental object self-interest,"<sup>410</sup> and he cites *Armstrong v. United States*, the takings case, for its language on not singling out individuals to bear public burdens.<sup>411</sup> Defining the standard for public and general, Souter finds that

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<sup>410</sup> *Winstar*, 518 U.S. at 896.

<sup>411</sup> *See id.* at 896-97.

a subsequent sovereign act will not create contract liability if its “impact upon public contracts is, as in *Horowitz*, merely incidental to the accomplishment of a broader governmental objective. . . . [W]here a substantial part of the impact of the Government’s action rendering performance impossible falls on its own contractual obligations, the defense will be unavailable.”<sup>412</sup> Souter defends this standard, correctly, as “striking a middle course between the[ ] two extremes”<sup>413</sup> of requiring complete generality and tolerating substantial governmental efforts of self-relief.<sup>414</sup>

Applying this standard to the facts of the case, Souter notes that it is of no import that FIRREA did not specifically target any thrifts: “Legislation can almost always be written in a formally general way, and the want of an identified target is not much security when a measure’s impact nonetheless falls substantially upon the Government’s contracting partners.”<sup>415</sup> Souter

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<sup>412</sup> *Id.* at 898. It is a little unclear what Souter means by “unavailable.” It is possible he means to suggest that a certain level of governmental self-interest will result in the doctrine not being applied at all. “The facts of this case do not warrant *application* of the [sovereign acts] doctrine.” *Id.* at 891 (emphasis added). This interpretation also gains some support from his similar treatment of the unmistakability doctrine. His analysis of the *application* of the unmistakability doctrine discusses the same arguments and issues that prior cases have analyzed in discussing the rule itself. On the other hand, Souter does proceed to apply the sovereign acts doctrine, and begins his subsequent analysis with: “[e]ven if FIRREA were to qualify as ‘public and general’.” *Id.* at 904. Finally, Souter explains at the end of his introductory section that the government must prevail on both the public and general requirement and the impossibility doctrine, so the better interpretation is that Souter’s test is for the sovereign acts doctrine itself, not its applicability. *See id.* at 896.

<sup>413</sup> *Id.* at 899 (footnote omitted).

<sup>414</sup> Schwartz appears to argue that Souter intended to apply a rule of complete generality. Schwartz relies on language from a footnote: “The generality requirement will almost always be met where, as in *Deming*, the governmental action ‘bears upon [the government’s contract] as it bears upon *all* similar contracts between citizens.’” Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 522-23 (quoting *Winstar*, 518 U.S. at 897 n.42 (quoting *Deming v. United States*, 1 Ct. Cl. 190, 190-91 (1865)) (emphasis added)). The better reading is that Souter does not intend this language to be the rule of decision; indeed, he even hedges it with “almost.” A requirement of complete generality does not square with the language, quoted above, that Souter sets forth in the text. *See also infra* Part II.A. (discussing Schwartz’s use of Souter’s footnote 42 to build a synthesis of the *Winstar* majority opinions).

<sup>415</sup> *Winstar*, 518 U.S. at 902-03.

logically rejects the dissent's argument, made also by the government, that the capital provisions are public and general because FIRREA consisted of twelve separate titles and took up 372 pages.<sup>416</sup> Souter also quickly dismisses the government's argument that FIRREA was public and general because it was enacted to "advance the general welfare," by expressing the hope for "nothing less of all congressional action."<sup>417</sup> The plurality's analysis relies heavily on the legislative history of the capital provisions, discussed above, that showed that opponents of FIRREA emphasized the direct effect on the goodwill promises made by the thrift agencies. Though Souter does not discuss directly the idea of adding a separate congressional intent element to the sovereign acts doctrine, his extended analysis of the legislative history largely accomplishes the suggestion that congressional intent should be relevant.<sup>418</sup>

The analysis could have stopped there, but to do so would necessarily have meant approval of the distinction between the sovereign and private roles of the government, since that is the logical lynchpin of the reasoning in *Horowitz* and *Jones*. Instead, the plurality opinion went further and required that the government also prevail on the common law contract defense of impossibility, even though none of the sovereign acts doctrine cases mention or apply this rule in any way.<sup>419</sup> Souter sets up the impossibility requirement with two related preliminary arguments. First, he "doubt[s] that a workable line can be drawn between the Government's 'regulatory' and 'nonregulatory' capacities."<sup>420</sup> At least in the case of the

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<sup>416</sup> See *id.* at 903 n.52. For the dissent's argument, see *id.* at 933-34.

<sup>417</sup> *Id.* at 903.

<sup>418</sup> Cf. Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 549 (criticizing Rehnquist's attack on Souter's reliance on legislative history). Schwartz interprets Souter's use of legislative history as "evidence that FIRREA has a substantial impact on government contractual obligations" and concludes that Souter's test for public and general is "an objective test of generality." *Id.* Whether the test of generality is objective or subjective is not particularly important. Evidence of either kind should be relevant in determining whether the government is taking advantage of its sovereign powers to unfairly reduce its contractual obligations.

<sup>419</sup> Cf. *id.* at 525 (arguing that Souter "assumes" the impossibility doctrine defines the limits of a sovereign acts defense); and *id.* at 527 (*Horowitz* does not seem to require that government prevail on impossibility doctrine). The impossibility defense allows a defendant to escape contract liability where performance was made impossible by conditions beyond the control of the defendant. See *infra* note 438 and accompanying text.

<sup>420</sup> *Winstar*, 518 U.S. at 894.

thrift merger approvals, the overriding goal of thrift regulation is protection of the federal deposit insurance fund and insurance looks like both a private and a regulatory function:

The regulation thus protected the Government in its capacity analogous to a private insurer, the same capacity in which it entered into supervisory merger agreements to convert some of its financial insurance obligations into responsibilities of private entrepreneurs. In this respect, the supervisory mergers bear some analogy to private contracts for reinsurance. On the other hand, there is no question that thrift regulation is, in fact, regulation. The inescapable conclusion from all of this is that the Government's "regulatory" and "nonregulatory" capacities were fused[.]<sup>421</sup>

But under the logic of *Horowitz*, it is not terribly difficult to keep the two roles of government separate in the case of deposit insurance. The government acts in a private capacity with respect to the deposit insurance when it fulfills its obligation to pay off depositors after a bank failure or when it follows agreements it makes with insured financial institutions regarding insurance premiums. It acts in a sovereign role when it requires deposit insurance as a condition for granting authority to engage in certain activities. This sort of distinction is exactly the distinction made by *Horowitz* and *Jones*.<sup>422</sup> Moreover, the regulatory agreements in *Winstar* did not relate to deposit insurance to regulatory approval of mergers and regulatory treatment of the thrifts relative to capital rules. The approvals related to deposit insurance only in the sense that almost all banking regulation aims, in some way, to minimize risk to the insurance fund.

Moreover, in the above-quoted language where Souter refers to the regulators' efforts "to convert some of its financial insurance obligations into responsibilities of private entrepreneurs,"<sup>423</sup> he is making a fairly disingenuous reference to the net worth maintenance agreements used by the regulators as a part of nearly every goodwill capital agreement.<sup>424</sup> As discussed in the Introduction of this Article, the net worth maintenance

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<sup>421</sup> *Id.* (emphasis added) (footnote omitted).

<sup>422</sup> In his dissent, Rehnquist argues: "By minimizing the role of lawgiver and expanding the role as private contractor, the principal opinion has thus casually, but improperly, reworked the sovereign acts doctrine." *Id.* at 931 (Rehnquist, C.J., dissenting).

<sup>423</sup> *Id.* at 894.

<sup>424</sup> *See id.*

agreements were provisions that required the owners of the combined (and newly chartered) thrifts to commit to infuse additional capital into the thrift to the extent necessary to bring the thrift into compliance with minimum capital rules.<sup>425</sup> In this way, the net worth maintenance agreements attempted to dissolve the limited personal liability of corporate shareholders.<sup>426</sup> Souter's allusion to these tells far less than half the story, however, because most courts that have interpreted these net worth maintenance agreements have found them to be unenforceable as contracts precisely because they are, instead, regulatory actions of the government.<sup>427</sup> According to the majority of courts which have analyzed the net worth maintenance agreements, they are not examples of the government acting in a private capacity. Souter, however, simply fails to mention this. Souter's analysis on the sovereign/private distinction is inconsistent in other ways as well.<sup>428</sup>

Souter's second preliminary argument is that *Horowitz* and *Lynch* stand for the proposition that all government agreements should be treated exactly as private contracts.<sup>429</sup> To use the terminology of Professor Schwartz, Souter advances a pure congruence theory: "the point [of *Horowitz*] was to put the Government in the same position it would have enjoyed as a private contractor."<sup>430</sup> To do so, however, Souter relies on

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<sup>425</sup> See *supra* notes 1-2 and accompanying text.

<sup>426</sup> The NWMA's were not unlike, but more ambitious than, the double liability provisions that applied to national bank shareholders from the Civil War through the Great Depression. See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *Double Liability of Bank Shareholders: History and Implications*, 27 WAKE FOREST L. REV. 31 (1992) (arguing that double liability worked very well both to reduce creditor losses and promote early resolutions, and resulted in clear, reasonable judicial rules).

<sup>427</sup> See *supra* note 24.

<sup>428</sup> Compare *Winstar*, 518 U.S. at 894 (holding that deposit insurance is comparable to private insurance), with *id.* at 897 n.42 ("[H]ere, the public contracts at issue have no obvious private analogs"). Souter also argues that the sovereign acts doctrine is better applied by distinguishing between "legislation that is relatively free of government self-interest and . . . statutes tainted by a governmental object of self-relief." *Id.* at 896. This distinction boils down to a distinction between sovereign and private capacities because the goal of self-relief in a sovereign capacity has little meaning, except to the same extent that raising taxes is an example of self-relief. Accord Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 522-23 n.196 (suggesting that Souter's analysis may be contradictory on this point).

<sup>429</sup> See *Winstar*, 518 U.S. at 892.

<sup>430</sup> *Id.*

ambiguous language from *Jones* and *Horowitz* and draws a strained conclusion from them. The language can be read as espousing pure congruence or as applying congruence rules only when necessary to avoid giving private plaintiffs an advantage they would not have against a private defendant:

In this court the United States appear simply as contractors; and they are to be held liable only within the same limits that any other defendant would be in any other court. Though their sovereign acts performed for the general good may work injury to some private contractors, such parties gain nothing by having the United States as their defendants.<sup>431</sup>

The first sentence supports the congruence theory, but the second suggests that it is limited to only certain factual situations where it would actually serve the government's interests. In deciding which reading makes more sense, one should remember that in *Deming*, *Jones*, and *Horowitz*, the plaintiffs sought to take advantage of the fact that both the party they contracted with and the party that caused the breach were part of the government. If the two governmental parties were treated as one and "the government" were subject to private contract rules, the plaintiffs would have a strong case. But the courts separated the government's sovereign and private roles so as to deny private plaintiffs the advantage they would otherwise enjoy. It was only to the private, separate part of the government that the courts applied the congruence rule, and it worked to the government's advantage to do so. Thus, the separation of roles that precedes the application of a congruence rule is itself fundamentally "exceptionalist," again using Schwartz's terminology. Souter glosses over this and seizes on the first sentence, expanding it to the conclusion that the government must suffer the application of all common law contract rules as if it had no sovereign role.<sup>432</sup>

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<sup>431</sup> *Id.* at 892-93 (quoting *Horowitz v. United States*, 267 U.S. 458, 461 (1925) (quoting *Jones v. United States*, 1 Ct. Cl. 383, 384 (1865))).

<sup>432</sup> *See id.* at 893-94. It is interesting to note that Souter might have chosen to distinguish *Deming*, *Jones*, and *Horowitz* on the grounds that they all involved contracts made in the government's private capacity (unlike *Winstar*, which involved regulatory agreements made in the government's sovereign capacity). *Cf.* Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 510 n.127 (noting that *Winstar* did not involve "Government functioning in its normal contractual role as purchaser of goods or services"). This, of course, would have meant recognizing the distinction between the sovereign and private roles, and would have effectively killed *Winstar*'s usefulness in a regulatory takings agenda.



Further evidence that Souter is incorrectly reading congruence into the case law appears in his reliance on language from *Lynch*, the case finding contract liability for congressional repeal of life insurance for World War I veterans. “When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.”<sup>433</sup> The “when” clause can be read as either purely rhetorical or as signaling a distinction between situations where the government is subject to congruence from those where it is not. This clause from *Lynch* contains essentially the same ambiguity that appeared in *Cooke v. United States*,<sup>434</sup> which held the government liable for forged commercial paper it had accepted and paid for where it only discovered the forgery much later due to its negligent delay:

Laches is not imputable to the Government, in its character as sovereign, by those subject to its dominion. . . . Still a government may suffer loss through the negligence of its officers. *If it comes down from its position of sovereignty, and enters the domain of commerce*, it submits itself to the same laws that govern individuals there. Thus, if it becomes the holder of a bill of exchange, it must use the same diligence to charge [fraud by] the drawers and indorsers that is required of individuals. . . .<sup>435</sup>

In holding that laches is not “imputable to the Government,” *Cooke* clearly means to distinguish between the government roles and apply the rules of private contracts to the government only when it actually “comes down from its position of sovereignty” and not when it acts as sovereign. This is the better reading of the “when” clause from *Lynch* as well. The Court in *Lynch* went on to describe the various ways in which the government made clear that it offered the life insurance in its private role, for example, by charging premiums.<sup>436</sup> Souter’s congruence reading ignores the more likely meaning of the conditional clause in *Lynch*. Both *Cooke* and *Lynch*, after all, distinguished between the sovereign and private roles,<sup>437</sup> so how can they support always treating the government as a private party?

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<sup>433</sup> *Winstar*, 518 U.S. at 895 (quoting *Lynch v. United States*, 292 U.S. 571, 579 (1934)).

<sup>434</sup> *Cooke v. United States*, 91 U.S. 389 (1875).

<sup>435</sup> *Id.* at 398 (emphasis added) (citations omitted).

<sup>436</sup> See *Lynch v. United States*, 292 U.S. 571, 576 (1934).

<sup>437</sup> See *Cooke*, 91 U.S. at 398; *Lynch*, 292 U.S. at 576-77 (distinguishing the insurance at issue from governmental “gratuities” which can be revoked at any time without contract liability).

In light of the ease with which the sovereign acts defense could have been rejected, in a manner fully consistent with both case law and commentary, it seems odd that the plurality would bother to stretch it in the two ways just outlined: blurring the distinction between sovereign and private roles and applying a pure congruence reasoning to all government agreements. The reason might be that this approach is necessary to avoid making arguments that would undermine the plurality's reasoning on the other defenses. First, these preliminary arguments lead into Souter's application of the common law contract doctrine of impossibility, an additional requirement not supported by case law. Souter explains the impossibility rule:

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.<sup>438</sup>

That is, if the parties were relying on the continuation of some condition but that condition changes, a party's duty to perform is released as long as that party was not responsible for changing the condition. Souter reasons that the government cannot pass the impossibility doctrine muster because the traditionally rapid pace of change in banking law and regulations made it inconceivable that the parties simply assumed the rules would stay the same.<sup>439</sup> Indeed, the rapid change is why they wanted a contract: "[I]t would be absurd to say that the nonoccurrence of a change in the regulatory capital rules was a basic assumption upon which these contracts were made."<sup>440</sup> Since continuation of the "rules" was not simply a tacit assumption of the parties, then, changing of the rules does not discharge the government from liability. This reasoning has a strongly tautological quality to it. For example, parties contracting about the price of goods to be purchased do not presume the continuation of prices, so of course a change in the price demanded would not excuse one party from liability. The impossibility doctrine is instead designed to deal with changing conditions that were *not* the subject of the bargaining, but were only background conditions or tacit assumptions, such as the continued legality of trade in the specific goods.

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<sup>438</sup> *Winstar*, 518 U.S. at 904 (quoting RESTATEMENT (SECOND) OF CONTRACTS § 261 (1979)).

<sup>439</sup> *See id.* at 905.

<sup>440</sup> *Id.* at 907.

The plurality's impossibility exercise is probably better explained by the need to deflect the traditional due process-based reasoning and what one commentator calls the "heavily regulated industry doctrine"<sup>441</sup> ("HRID"). This is simply the idea that when a person enters into a heavily regulated industry, reasonable expectations of secure property rights in the corporation are necessarily limited. The idea also shows up in criminal law. For example, it appears in the presumption that one who owns or uses explosives has prior notice of applicable prohibitions simply because explosives have traditionally been heavily regulated. This reasoning is based on the due process concerns for notice, and it puts the risk of governmental changes to the rules squarely upon the private party. Banking has long been considered a heavily regulated industry and numerous cases have used this HRID reasoning to shield the government from liability.<sup>442</sup> In each instance where this notion is employed, the government was acting in a sovereign capacity. If this sort of due process analysis were applied to the facts of *Winstar*, the inescapable result would be that the thrift owners were engaged in a heavily regulated industry and therefore bore the risk of congressional change. This tension in Souter's reasoning has no impact on his analysis of the sovereign acts doctrine, but it would completely undermine the plurality's reasoning regarding the unmistakability doctrine, under which the agencies are presumed to have made the promise to pay damages resulting from congressional changes to the capital rules. This directly contradicts the HRID.

Souter does admit, in a footnote, to the due process basis of the sovereign acts doctrine, but does not discuss any of the logical tension between application of due process analysis and the presumption of congruence.<sup>443</sup> Due process concerns are fundamentally based on the fairness of a sovereign's treatment of an individual, whereas congruence treats the government as the legal equal of a private citizen. Souter would perhaps respond with the language he cites from *United States v. Bekins*,<sup>444</sup> that the government's capacity to make contracts is "'of the essence of sovereignty' itself."<sup>445</sup> This reasoning is simply oxymoronic. A sovereign

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<sup>441</sup> Graham, *supra* note 267.

<sup>442</sup> See, e.g., *Fahey v. Mallonee*, 332 U.S. 245 (1947); *California Housing Securities, Inc. v. United States*, 959 F.2d 955 (Fed. Cir. 1992) (finding no taking under the Fifth Amendment for RTC conservatorship and receivership and noting that the highly regulated nature of banking put thrift owners on notice of the changing regulatory burdens that could impact their investment value).

<sup>443</sup> See *Winstar*, 518 U.S. at 898 n.43.

<sup>444</sup> *United States v. Bekins*, 304 U.S. 27 (1938).

<sup>445</sup> *Winstar*, 518 U.S. at 884 (quoting *Bekins*, 304 U.S. at 51-52).

does not exert sovereignty by bargaining its way to binding agreements or by seeking approval or permission. A sovereign, by definition, imposes its will unilaterally. Due process reasoning is necessarily aimed at judging the fairness of these acts of dominion. Due process analysis, therefore, stands as the unacknowledged alternative to the contractual, congruence reasoning employed by the plurality (and the other majority opinions). A key difference in these perspectives is that contractual analysis is limited to discerning the intent of the parties, while due process analysis looks much more broadly to the full context surrounding the government's actions. This difference lies at the core of the problems of *Winstar*.<sup>446</sup>

In addition to deflecting the more appropriate due process analysis, there is a second major reason to blur the distinction between the sovereign and private roles of the government and to adopt a pure congruence theory. Without taking these positions, it would be nearly impossible for the plurality to avoid inconsistency with its earlier reasoning on the express delegation doctrine. Just as the plurality's analysis in the express delegation doctrine obscured the distinction between the agencies and the government, so too does the plurality's analysis of the impossibility doctrine. In describing the impossibility doctrine, Souter hints that he means to treat the governmental party as only the agency: "[T]he Government, like any other defending party in a contract action, must show that the passage of the *statute* rendering its performance impossible was an event contrary to the basic assumptions on which the parties agreed."<sup>447</sup> By use of the word "statute," Souter apparently means to treat the agency as separate from Congress and not necessarily contractually responsible for the passage of the statute.<sup>448</sup> This would be consistent with the *Southern Utilities* logic and

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<sup>446</sup> The dissent, unfortunately, does not seem to appreciate this fully. In criticizing Souter's citation of a due process landmark, *Hurtado v. California*, 110 U.S. 516, 535-536 (1884), Rehnquist writes:

Surely this marks a bold, if not brash, innovation in the heretofore somewhat mundane law of government contracts; that law is now to be seasoned by an opinion holding that the Due Process Clause of the Fourteenth Amendment did not make applicable to the States the requirement that a criminal proceeding be initiated by indictment of a grand jury.

*Winstar*, 518 U.S. at 932 (Rehnquist, C.J., dissenting). Rehnquist does not address the deeper implications of holding a sovereign to contract rules that were designed to govern legally equal parties, neither one of which has sovereign power over the other.

<sup>447</sup> *Winstar*, 518 U.S. at 904 (emphasis added).

<sup>448</sup> See *id.* at 904-05.

express delegation doctrine precept that agreements by agencies should be presumed to bind only the agency. It would also explain the language describing the impossibility rule, which refers to an event occurring “without his fault.” Recalling Speidel’s thorough analysis of situations where agency X’s contracts are impossible to fulfill because of the actions of agency Y, one would think that the parties in *Winstar* similarly presumed that other agencies would not somehow affect the agreements. It is important to keep an eye on which party is responsible for which acts in order to understand both the impossibility and the express delegation doctrines.

Yet Souter immediately obscures his working definition of exactly who is the governmental party when he applies the impossibility doctrine. “[T]here is no doubt that some *changes in the regulatory structure* governing thrift capital reserves were both foreseeable and likely when these parties contracted with *the Government*.”<sup>449</sup> Certainly, “changes” were foreseeable, both due to agency changes and congressional changes. This same ambiguity as to who makes the change appears throughout Souter’s application of the impossibility doctrine, which fittingly concludes with: “[I]t would be absurd to say that the nonoccurrence of a change in the regulatory *capital rules* was a basic assumption upon which these contracts were made.”<sup>450</sup> It is unclear which rules the parties were bargaining about. If it was the regulations only, then Souter has contradicted his analysis of the express delegation doctrine because then it would be obvious that the agreements meant to say nothing about what Congress would do, consistent with the interpretive presumption from *Home Telephone & Telegraph* and *Southern Utilities*. If, on the other hand, “rules” refers to both regulations and statutes, then Souter is not in fact treating the agencies as separate from Congress and the “Government” as a whole. His use of the impossibility doctrine fails because it becomes the tautology described above: if the entire “Government” is the contracting party, then the continued absence of a new statute must have been a central part of what the parties were bargaining about. Souter tries to have it both ways: FIRREA is an event far enough removed from the parties’ control that the impossibility analysis makes sense, but at the same time, “the Government” agreed not to change the “capital rules.” For this to have any coherency (or perhaps merely to go unnoticed), Souter simply must argue that there is no distinction between the sovereign and private roles of the government and that the government’s agreements are all to be analyzed and enforced under a

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<sup>449</sup> *Id.* at 906 (emphasis added).

<sup>450</sup> *Id.* at 907 (emphasis added).

congruence theory. These assumptions run counter to the better reading of the relevant case law and to modern interpretations of administrative law.

Souter almost escapes this logical contradiction by making his most explicit distinction between the agencies and Congress in the next section of his analysis.<sup>451</sup> Unfortunately, this reasoning repeats his error of ignoring the Anti-Deficiency Act and the externalities his opinion creates by finding that agencies presumptively create damages liability for the Treasury:

The mere fact that the Government's contracting agencies (like the Bank Board and FSLIC) could not themselves preclude Congress from changing the regulatory rules does not, of course, stand in the way of concluding that those agencies assumed the risk of such change, for determining the consequences of legal change was the point of the agreements. It is, after all, not uncommon for a contracting party to assume the risk of an event he cannot control, even when that party is an agent of the Government. As the Federal Circuit has recognized, "[Government] contracts routinely include provisions shifting financial responsibility to the Government for events which might occur in the future. That some of these events may be triggered by sovereign government action does not render the relevant contractual provisions any less binding than those which contemplate third party acts, inclement weather and other *force majeure*."<sup>452</sup>

This passage also shows Souter, once again, leaping the logical gap between what parties sometimes agree to and what they should be presumed to have agreed upon. As to the question of the authority with which the agencies may bind Congress to a promise to pay damages, the only answer is the pure congruence theory combined with the Holmesian presumption of damages.

Without this otherwise unnecessary detour into the impossibility doctrine, Souter would have been left with *Horowitz's* distinction between the government's dual roles as the logical and precedential center of his sovereign acts doctrine reasoning. And that would certainly have called greater attention to the interpretive and analytical flaws buried within the rest of the opinion.

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<sup>451</sup> See *id.* at 907-10.

<sup>452</sup> *Id.* at 908-09 (quoting *Hughes Communication Galaxy, Inc. v. United States*, 998 F.2d 953, 958-59 (Fed. Cir. 1993)).

#### 4. *Scalia's Analysis of the Sovereign Acts Doctrine*

The other majority opinions contribute little. Justice Breyer's opinion does not discuss the sovereign acts doctrine.<sup>453</sup> Justice Scalia takes a different tack and argues that the sovereign acts doctrine adds nothing to the unmistakability doctrine.<sup>454</sup> Both doctrines, he argues, aim to decipher whether "the Government was committing itself not to rely upon its sovereign acts in asserting (or defending against) the doctrine of impossibility, which is another way of saying that the Government had assumed the risk of a change in its laws."<sup>455</sup> In short, the major flaw in this analysis is that it, too, ignores any distinction between the agencies and the government. If all agency actions are presumed to bind the government, including presumptive promises to pay damages, then this reasoning makes sense. Scalia fails, however, to square this view with *Home Telephone & Telegraph*, the Anti-Deficiency Act, or the more reasoned interpretation of the agreements.

Scalia then cites *Lynch* and *Perry* (the *Gold Clause Cases*) for the proposition that the quoted language is the proper interpretation of *Horowitz*.<sup>456</sup> Scalia is correct that neither *Lynch* nor *Perry* mention *Horowitz* even though both were decided after it.<sup>457</sup> But both are fully consistent with *Horowitz* when it is read as a doctrine separate from unmistakability. *Lynch* is consistent because the subsequent legislation specifically targeted the contracts which the government had made earlier in its private capacity and so could not be classified as public and general.<sup>458</sup> Liability makes sense then. It should be noted that the agencies issuing the life insurance in *Lynch* were specifically authorized to issue insurance contracts and later convert them "into ordinary life . . . and other usual forms of insurance."<sup>459</sup> *Lynch* also struck down the breaching provision on due process grounds, rather than ordering payment of damages on a congruence theory. *Perry* is also consistent with the broader reading of *Horowitz* because the subsequent breaching legislation in

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<sup>453</sup> See *id.* at 910-18 (Breyer, J., concurring).

<sup>454</sup> See *id.* at 919-24 (Scalia, J., concurring).

<sup>455</sup> *Id.* at 923-24 (Scalia, J., concurring).

<sup>456</sup> See *id.* at 924 (Scalia, J., concurring).

<sup>457</sup> See *id.* (Scalia, J., concurring).

<sup>458</sup> Cf. Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 679 (arguing that the insurance repeal legislation in *Lynch* is not an example of "complete generality").

<sup>459</sup> *Lynch v. United States*, 292 U.S. 571, 572 n.1 (1934). Thus, the government should have lost on an express delegation defense in *Lynch* also.

*Perry*—abolishing gold-convertibility of dollars—had an effect of such generality that the Court found it impossible to compute damages.<sup>460</sup> The finding of no damages makes sense.

Justice Rehnquist's arguments in his dissent are summarized above.<sup>461</sup> Suffice it to say he criticizes Souter's blurring of the distinction between the government's dual roles, but then unwisely proceeds to accept the government's argument that the length and breadth of FIRREA render any of its provisions sufficiently public and general to deny liability.<sup>462</sup>

In sum, the four defenses offered by the government in a shotgun approach had very different strengths. The reserved powers doctrine seems more a relic of legal history than a viable defense today. Indeed, its notion that an entire category of government powers cannot be bargained away is difficult to square with the unmistakability doctrine's recognition that sovereign powers can be bargained away if done so explicitly. The unmistakability doctrine was developed for situations where the sovereign directly enters into an agreement and then, usually several generations later, revisits that bargain when it has become a burden to society. It is difficult to see why that description should not apply to the goodwill capital provisions, as *Winstar* could add \$30 to \$40 billion to the cost of the cleanup.<sup>463</sup> *Winstar*'s agreement seems to have unmistakably clear language that the agency will not change its regulations, but the others lack such language. Because the doctrine is an interpretive device, it is difficult to see why it should not apply here, especially when not applying it leads to the collateral theoretical difficulties discussed above. The express delegation doctrine rises above the other three as the one defense that should have prevailed on the government's behalf. As an interpretive doctrine, it should have clarified that the "parties" were the thrifts and the thrift agencies, not the entire government, and that the parties were bargaining only about the regulations promulgated by the agency under its existing authority. Finally, the sovereign acts doctrine, put forward by the government without much hope that it would succeed, gave the plurality the narrow window of opportunity it needed to reread several cases with a pure congruence agenda and import the common law doctrine of impossibility. This doctrine offered the only means the plurality had to explain away the due process notion that owners of thrifts cannot reasonably expect that the

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<sup>460</sup> *Accord* Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 681.

<sup>461</sup> *See supra* note 446.

<sup>462</sup> *See* *United States v. Winstar Corp.*, 518 U.S. 839, 926-29, 933-34 (1996) (Rehnquist, C.J., dissenting).

<sup>463</sup> *See* Schmitt, *supra* note 15.



government's heavy regulation of the industry will not undermine their property rights from time to time. The analytical (and literal) lengths that Souter's analysis goes to reach its results strongly suggests an overpowering motivation to achieve the regulatory takings agenda that has so far eluded a majority of the Court.

*F. The Implications of Winstar*

The first step to understanding the implications of *Winstar* is to reconcile the three opinions comprising the majority to the extent possible, in order to formulate a coherent rule of the case. Souter's analysis clearly dominates the majority's reasoning on most issues. One would not go far astray in simply considering it the majority opinion. Justice Breyer, who joined Souter's opinion in full, wrote separately to emphasize his understanding of the unmistakability doctrine as simply an example of normal rules of contract construction.<sup>464</sup> Governments do not normally give up their sovereign power, and the presumption simply reflects that observation. Breyer's reading of federal unmistakability cases finds their presumptions fairly weak.<sup>465</sup> This interpretation of the unmistakability doctrine leaves it so weakened, relative to the state cases, that the issue of whether the doctrine applies or not is virtually moot. Breyer's hints that the unmistakability doctrine might still apply do not change the functioning of Souter's rule. Neither does Scalia's more direct insistence that the unmistakability doctrine should apply.<sup>466</sup> One could count five votes for the proposition that it applies: Scalia, Kennedy, Thomas (in concurrence), and Rehnquist and Ginsburg (in dissent).<sup>467</sup> But such an exercise is virtually pointless, because Scalia's treatment of the unmistakability doctrine leaves it an empty shell compared to what the state cases set forth. The three

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<sup>464</sup> See *Winstar*, 518 U.S. at 910-18 (Breyer, J., concurring).

<sup>465</sup> As noted above, Breyer ignores the state cases and leaves unmentioned Souter's assertion that the unmistakability doctrine arises from inherent attributes of sovereignty, which would imply that the doctrine should apply equally to state and federal governments.

<sup>466</sup> See *Winstar*, 518 U.S. at 920. Cf. Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 542 ("The practical effect of [Scalia's reading of unmistakability], however, is close to that of Justice Breyer, who avoids the second promise requirement by questioning whether any generic unmistakability requirement even exists.").

<sup>467</sup> See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 546 (arguing that there are five votes rejecting Souter's use of the Holmesian presumption to "recharacterize" the agreements as promises to pay damages).

majority opinions offer little divergence of opinion on the three other defenses claimed by the government. The plurality opinion, therefore, can be treated as the majority opinion.

Professor Schwartz argues that combining the opinions into a coherent rule is more complicated.<sup>468</sup> Schwartz proposes two versions of synthesis: one reconciling the *Winstar* opinions and their overlapping rationales, and the other adopting a broader approach that I will discuss below in Part II.<sup>469</sup> Schwartz's reconciliation of the majority opinions in *Winstar* is the most ambitious and thorough yet published. He concludes that the strength of the unmistakability presumption should not be separated from the level of generality, within the meaning of the sovereign acts doctrine, achieved by the subsequent legislation:

In short[,] there appears to be a consensus emerging that the level of proof required to rebut the ordinary presumption that the Government does not agree to curtail its own sovereign powers is a variable that depends on the level of generality of the Government's [subsequent] interfering action and the extent to which it directly undoes the Government's contractual undertaking.<sup>470</sup>

Schwartz's analysis is much more balanced than the Court's, but the synthesis does little to improve the clarity of the standards set forth by the *Winstar* majority. On the other hand, courts will need to revisit *Winstar* a great many times before its rules become clearer than Schwartz's prediction.<sup>471</sup>

There are several levels of implications of *Winstar*. First, agencies now face a dilemma when making agreements with regulated entities that relate to the use of the regulatory power. The agencies could begin to include language in all their agreements reserving for themselves, and for Congress, the power to change the underlying regulations and statutes, respectively. This would probably insulate them, and the Treasury, from contract claims for damages whenever circumstances require a correction in regulatory strategy. The problem, of course, is what that implies about the thousands of preexisting regulatory agreements the agencies reached

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<sup>468</sup> See *id.* at 481.

<sup>469</sup> See *infra* Part II.

<sup>470</sup> Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 556.

<sup>471</sup> A few others have analyzed *Winstar* as well. See, e.g., Martinez, *supra* note 298, at 1193 (arguing that *Winstar* did not affect the government's sovereign power to tax, which is so broad as to border on unfair).

without such language. The most prudent strategy—broad inclusion of reservations of authority—could be used as evidence that the agencies view the pre-*Winstar* agreements as giving the authority away. The regulators now face a grim dilemma.

*Winstar* thereby gives a big boost to the regulatory takings agenda. Regulatory takings proposes that any time a new law or regulation diminishes a property value, the government should be required to compensate the owner for the diminution in value, even if partial or temporary. *Winstar* does not bring the entire agenda along with it; only those plaintiffs who can show something resembling a contract will succeed on a *Winstar* theory. But it is terribly simple to imagine contracts analogous to the regulatory merger approvals here. Certainly a building permit, such as the one South Carolina issued to David Lucas, would seem to suffice, even if the new regulation did not destroy all economic value of the land.<sup>472</sup> Indeed, a huge variety of the activities likely to be subject to new regulations already involve some sort of approval or licensing by the government. A reasonable prediction is that other *Winstar* cases will begin to arise where the initial approval involved a great deal of bargaining, supporting a fairness rationale behind the plaintiffs' claims of reliance. But there is no reason to think that extensive bargaining is necessary to support claims of reliance or even fairness, just as it is unnecessary to support the existence of a contract. One would hope that new restrictions on drivers' licenses would not someday create *Winstar* damages, but such a claim is certainly consistent with the regulatory takings agenda and *Winstar*.

The broadest implication of *Winstar* is a new tension in the theory behind regulatory agreements. On the one hand, *Winstar* argues for the strongest possible form of congruence, treating the government as any other private contracting party, even when its agreements relate to regulatory treatment of a regulated entity. Under this contractual analysis, the agencies need only have enough statutory authority to pass a low standard of traditional ultra vires analysis. *Winstar* did not, after all, compare the promises allegedly made by the FHLBB to its authority to set minimum capital levels specific to an individual institution, as one would expect under *Home Telephone & Telegraph*. Instead, it compared the goodwill agreements to the FHLBB's authority to "make contracts" and to provide guaranties against loss. These latter statutes would support *Winstar*'s theory of an agency commitment to pay damages for breach of

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<sup>472</sup> See *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992) (finding a taking where environmental regulation eliminated all economic value of shoreline wetlands).

virtually *any* substantive promise. This sort of ultra vires standard strongly suggests that the agency will always have authority to promise damages, regardless of the treatment or action promised, because it is the meeting of the minds and the reliance thereon that support the agreement's enforceability.

Conversely, courts have traditionally analyzed regulatory agreements not as contracts but as orders, enforceable if consistent with the agencies' authority. Courts evaluate the limits of this authority with a somewhat stricter analysis than the ultra vires analysis, and ignore the reliance claims of the regulated entity. For example, banking agencies have the authority to impose conditions upon regulatory approvals, such as new charters or approvals of mergers or acquisitions. The court in *Kaneb Services, Inc. v. FSLIC*<sup>473</sup> upheld FSLIC's imposition of restrictions on dividends as a condition to approval of a holding company's acquisition of a thrift. The court noted that a statute<sup>474</sup> gave FSLIC the authority to consider the financial strength of the acquirers in granting approvals and that the agency's "broad discretionary power" included the power:

[T]o impose conditions upon approval of an acquisition by a savings and loan holding company. Otherwise, it would not have been necessary to give authority to the FSLIC to initiate cease and desist proceedings for violations of "any condition in writing imposed by [FSLIC] in connection with the granting of any application."<sup>475</sup>

Under this view, the agency has the power to impose conditions under its regulatory authority and to enforce those conditions under its enforcement authority. The approval, and its conditions, are not seen as a contract, enforceable by virtue of the meeting of the minds of the parties or the holding company's reliance upon their so-called bargain.

Another typical example is *Groos National Bank v. Comptroller of the Currency*,<sup>476</sup> which rejected the argument that consideration was necessary to support formation of a regulatory agreement. In *Groos*, the agency had issued a cease-and-desist order relating to credit concentration and insider lending. When the bank violated the consent order, the agency brought a contested enforcement action against the bank and issued another order

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<sup>473</sup> *Kaneb Servs., Inc. v. FSLIC*, 650 F.2d 78 (5th Cir. 1981).

<sup>474</sup> 12 U.S.C. § 1730a(e)(1).

<sup>475</sup> *Id.* at 82.

<sup>476</sup> *Groos Nat'l Bank v. Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978).

after administrative litigation.<sup>477</sup> In rejecting the bank's argument that the consent order lacked consideration, the court distinguished the contractual analysis as inapplicable to the consent order:

This argument is without merit. The statute provides that a cease and desist order may issue upon any violation of an agreement between the agency and a bank and says nothing of consideration. *Nor is there any reason to import the common law of consideration, proper to private contractual relations, into the relationships between a regulatory agency and the entity it regulates.*<sup>478</sup>

An even stricter view of agency authority appears in the short but significant line of cases that began with *Wachtel v. United States Department of Treasury, Office of Thrift Supervision*.<sup>479</sup> In *Wachtel*, the new owners of a thrift promised to infuse capital as necessary to keep the thrift's capital levels above the regulatory minimums. The promises took the form of a consent order issued under the statutory authorization.<sup>480</sup> When the thrift's financial conditioned weakened, the owners refused to infuse capital and the agency sued for compliance with the net worth maintenance obligation by bringing a cease-and-desist action under § 1818(b).<sup>481</sup> The court struck down the cease-and-desist order on the ground that the agency could require payment of funds only via its restitution authority, but the restitution order would not lie because the agency could not make the required statutory showing of unjust enrichment under § 1818(b)(6).<sup>482</sup> The D.C. Circuit Court later reached the same conclusion on essentially the same reasoning in *Rapaport v. United States Department of Treasury, Office of Thrift Supervision*.<sup>483</sup> Despite flaws in these courts' analyses, their conception of the consent orders is more consistent with that of *Groos* and *Kaneb* than with the contractual view of *Winstar*. The major

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<sup>477</sup> See *id.* at 892-93.

<sup>478</sup> *Id.* at 896 (emphasis added).

<sup>479</sup> *Wachtel v. United States Department of Treasury, Office of Thrift Supervision*, 982 F.2d 581 (D.C. Cir. 1993).

<sup>480</sup> See 12 U.S.C. § 1818(b).

<sup>481</sup> See *Wachtel*, 982 F.2d at 582.

<sup>482</sup> See *id.* at 586.

<sup>483</sup> *Rapaport v. United States Department of Treasury, Office of Thrift Supervision*, 59 F.3d 212 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 774 (1996). The court in *Rapaport* expanded upon the definition of unjust enrichment, holding that it required a showing that the funds at issue must have come *out of* the bank for the claim to constitute unjust enrichment. See *id.* at 216 (emphasis added).

difference is the level of scrutiny, but the type of analysis is the same: a comparison with the specific regulatory authority to impose the substantive provisions at issue. The meeting of the minds is not sufficient for the original consent orders to be enforceable. Moreover, neither *Wachtel* nor *Rapaport* mentioned any reliance interest the agencies might have had arising from the thrift owners' promises.<sup>484</sup>

Under *Winstar*'s analysis, the meeting of the minds is the source of the enforceability, and scrutiny of the thrift agencies' power to enter into contracts is a rubber stamp. The power of the agency to accept a promise to maintain the capital of the thrift should certainly pass muster under *Winstar* because the agencies had the statutory power to "make contracts" and to create individualized capital requirements. Net worth maintenance provisions were agreed to in very much the same process as the goodwill capital agreements—indeed, the net worth maintenance provisions were required as a part of nearly all the approvals allowing goodwill<sup>485</sup>—and the agencies relied upon the net worth maintenance provisions as much as the thrift owners relied upon the goodwill provisions. Either party would have been "mad" to make the bargain without these respective provisions.

*Winstar* muddies the theory behind consent agreements. If the agencies can make implied promises to pay billions of dollars, then why can they not enforce owners' agreements to infuse capital into ailing thrifts? The only apparent reconciliation of this tension is that the government must pass through both strictures in its regulatory agreements. This, of course, totally flips cases like *Jones* and *Cooke* on their heads. *Jones* attempted to keep private plaintiffs from taking advantage of a government agency when it contracted and later a different arm of the government enacted a rule rendering performance impossible.<sup>486</sup> *Cooke* also spoke of a limited form of congruence, applicable only where the government acted in a private capacity.<sup>487</sup> Now *Winstar* expands this congruence beyond what the word

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<sup>484</sup> It is also interesting to note that both *Wachtel* and *Rapaport* began their analysis by finding that the banking agencies merited no deference under *Chevron* to interpret § 1818 because there are several agencies that use the same statute, making possible divergent interpretations of the same statute. See *Wachtel*, 982 F.2d at 585; *Rapaport*, 59 F.3d at 216. In addition to the several analytical problems with its reasoning, this conclusion is interesting because it implies different roles for the different agencies. This recognition of the separation of the agencies from each other and, therefore, from "the Government," is difficult to square with *Winstar*'s view of a unitary government.

<sup>485</sup> See Jackson, *supra* note 23, at 521 n.37.

<sup>486</sup> See *Jones v. United States*, 1 Ct. Cl. 383 (1865).

<sup>487</sup> See *Cooke v. United States*, 91 U.S. 389 (1875).

itself can support. The new “exceptionalism” means that the government gets the worst of both worlds when it enters into regulatory agreements. The agreements are not contracts when the government seeks to enforce them, but they are contracts when they are enforced against the government. This theoretical incoherence is likely to cause ancillary inconsistencies in the jurisprudence of regulatory agreements before it is ultimately worked out. If it survives, the likely result of the *Winstar* worldview is the erosion of the heavily regulated industry doctrine as a basic principle of due process. Government agencies’ new one-sided ability to promise that the Treasury will pay for the inconvenience of any changes in regulation can only result in a contractual reliance version of the regulatory takings agenda. This elevates consent of the governed to essentially a requirement of consensus. Those with large economic interests can hold the majority hostage and demand compensation for any change in their privileged status.

## II. PROPOSED FRAMEWORK TO DECIDE WHEN A GOVERNMENT AGENCY MAY RAISE SPECIAL CONTRACT DEFENSES

This Part suggests a revision of the distinction between the sovereign and private roles of the government as the starting point to a more rational relationship between the government’s special contract defenses. Even if one focuses only on the regulatory approvals of the thrift mergers involving goodwill capital, *Winstar* creates a contradiction by claiming that these approvals are contracts even though the courts have treated different provisions of the same approvals—the net worth maintenance provisions—as sovereign actions and therefore something other than contracts.<sup>488</sup> The proposed distinction between the government’s sovereign and private roles would provide a rational limit on the government’s ability

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<sup>488</sup> See, e.g., *In re Overland Park Fin. Corp.*, 232 B.R. 215, 228 n.23 (D. Kan. 1999) (reversing the bankruptcy court’s finding that the net worth maintenance provision was not subject to the super-priority provisions of 11 U.S.C. § 365(o) (requiring the cure of deficiencies as a prerequisite to bankruptcy proceedings), but questioning OTS’s right to file proof of claim on behalf of RTC). As many goodwill cases as there are, there are probably an equal number of net worth maintenance agreement cases working their way through the courts. Many follow a similar path as *Overland Park*, where the holding company, which entered into a net worth maintenance provision, files for bankruptcy protection in order to dispose of the net worth maintenance obligations. Of course, the tension in the analysis of regulatory agreements extends to other types of provisions and other agencies.

to claim the unmistakability and express delegation doctrines, for these defenses should not have any application when the agreement at issue is a typical government contract, such as procurement or employment. Most of the criticism of the distinction between sovereign and private roles arises from the practical difficulty in establishing standards, not from the doctrinal need for the distinction.

This Part proposes an alternative framework for the special contract defenses that arose in *Winstar*. Unlike the plurality in *Winstar* and the earlier Supreme Court decisions interpreting these special defenses, this proposal takes a broader view of the goals of each defense and how these goals can and should interact. Viewing the defenses as logically separate and independent, as these cases do, leads the courts to apply the defenses seriatim, oblivious to the redundancies or contradictions this creates. For example, the reserved powers doctrine holds that certain sovereign powers (the “police powers”) cannot be bargained away by the state, but the unmistakability doctrine allows the government to do so, provided the provision is unmistakably clear. Yet, no court has ironed out just how these two defenses should interact.

Another example is a promise, like the one in *Winstar*, made by the government in its sovereign capacity. Should the government be allowed to plead the sovereign acts doctrine where the government made the original agreement in its sovereign role? The sovereign acts doctrine has traditionally focused on agreements that the government originally made in its private capacity, and later breached in its sovereign capacity. It makes sense, therefore, to focus on the government’s role in making the original agreement in determining which defenses the government can raise.

This Part begins with a critique of what may be the only proposed integration of the defenses. Because this proposal integrates *Winstar*, it suffers the same logical and doctrinal flaws of the majority opinions. Next, I describe my proposed framework, including factors for determining which role the government is using. I hope to show that these factors for determining whether the government is acting as sovereign or in its private role explain nearly all the relevant holdings. Finally, I attempt to demonstrate that each of the major precedents discussed herein are consistent with my framework, with the exception of *Winstar*. The goal of the proposed framework is to integrate both the sovereign power and contractual perspectives into a framework where each is used where, and only where, it makes sense. The result should improve the balance—achieved by either *Winstar* or the case law prior to *Winstar*—between the need for the majority to update regulatory policies freely and the legitimate reliance interests of individuals.



A. *A Critique of Professor Schwartz's Integration of the Defenses*

Few commentators have proposed a comprehensive framework for the special defenses argued in *Winstar*. Professor Schwartz has made the most ambitious proposal, though it is conceived of as a synthesis of the *Winstar* opinions rather than as a proposal for an alternative framework.<sup>489</sup> Schwartz proposes a two-tiered approach in which the government would enjoy the protection of a strong version of the unmistakability doctrine only in cases where the subsequent, breaching legislation achieved complete generality.<sup>490</sup> A second tier would provide a weaker unmistakability defense where the subsequent legislation achieved an intermediate level of generality.<sup>491</sup> The core of Schwartz's argument is that a majority of the *Winstar* justices agree that the unmistakability and sovereign acts doctrines overlap, and that it makes sense to build a synthesized framework upon this agreement.<sup>492</sup> Schwartz demonstrates considerable interpretive skill in piecing together this coalition, but because the coalition includes the dissenters,<sup>493</sup> it must remain highly speculative that a majority would agree on the application of his synthesis to any given factual scenario.

By seeking to build a synthesis on the foundation of *Winstar*, however, Schwartz's analysis does not focus enough on the different goals of the unmistakability and sovereign acts doctrines. Although both doctrines seek, on a general level, to balance the need to protect the government's ability

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<sup>489</sup> See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13.

<sup>490</sup> See *id.* at 560.

<sup>491</sup> See *id.* at 561-62.

<sup>492</sup> Although Scalia's concurrence and Rehnquist's dissent touch briefly on the issue of how the unmistakability and sovereign acts defenses relate to one another, their debate is limited to brief comments that these two doctrines may serve the same purposes. See *Winstar*, 518 U.S. at 923 (" 'sovereign acts' doctrine adds little, if anything, to the 'unmistakability' doctrine"). *Id.* at 937 (Scalia, J., concurring) ("To the extent that the unmistakability doctrine is faithfully applied, the cases will be rare in which close and debatable situations under the sovereign acts doctrine are presented."). *Id.* (Rehnquist, C.J., dissenting). See also Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 501 n.97 (arguing that Souter implies in his footnote 22 that the federal government cannot claim both the sovereign acts and unmistakability defenses). On a general level, it is certainly true that both doctrines aim to protect the government's sovereign powers.

<sup>493</sup> Schwartz argues that Scalia would apply a combination of the two in effect as one defense, while Rehnquist would apply each separately. See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 552 (suggesting that Scalia's "integration of the two doctrines" is the "more complete").

to enact new laws and the need of private parties to rely on government promises, the two doctrines have very different focuses and mechanisms. The unmistakability doctrine turns on an analysis of the initial promise. It seeks to prevent the sovereign from restricting future generations by giving away too much sovereign power.<sup>494</sup> At bottom, the unmistakability doctrine seeks to improve the accountability of those legislators who would make long-term commitments by forcing the consequences of their actions to become more immediately apparent.

The sovereign acts doctrine, by contrast, scrutinizes the generality of the subsequent breaching legislation.<sup>495</sup> It is not an interpretive doctrine aiding the courts to construe the original promise. In sovereign acts cases decided so far, the original promise is usually made in the government's private capacity. The sovereign acts doctrine is not concerned with accountability for giving away a certain power, but rather with preventing the government's run-of-the-mill, past promises from discouraging new legislation about matters that have only a tangential effect on the original promise. The sovereign acts doctrine does little to encourage more accountability in government. The two doctrines scrutinize different things and the government's initial promise is, at least usually, made in different capacities. Schwartz does not address these differences in the doctrines nor does his synthesis answer why, if the two doctrines were applied separately, some of the four possible outcomes might not make sense.<sup>496</sup>

Schwartz argues that the sovereign acts doctrine, which came into existence immediately after the Civil War, provided the federal government with a defense powerful enough to make unmistakability doctrine unnecessary as a practical matter.<sup>497</sup> The relative paucity of unmistakability cases involving the federal government (compared to cases involving

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<sup>494</sup> See *id.* at 485 (citing *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986)).

<sup>495</sup> See *id.* at 485-86 (citing *Horowitz v. United States*, 267 U.S. 458 (1925)).

<sup>496</sup> In his 1975 analysis of the sovereign acts doctrine, Professor Latham similarly avoids discussing how his analysis would interact with the other defenses. See Latham, *supra* note 380. The same goes for Professor Spiedel's insightful discussion of the sovereign acts doctrine. See Spiedel, *supra* note 298.

<sup>497</sup> See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 500 (contending that the sovereign acts doctrine occupied the field and therefore there are few federal unmistakability cases); *id.* at 525 (writing that the sovereign acts doctrine "served in the earliest decisions of the Court of Claims as a kind of proto-unmistakability rule rather than as an application of the impossibility doctrine"); see *id.* at 504 (arguing the sovereign acts doctrine has filled the gap by giving the federal government the sort of protection unmistakability would have given it).

states) therefore demonstrates the overlap of the unmistakability and sovereign acts doctrines, according to Schwartz's reasoning.

The better explanation is that the federal government rarely entered directly into the sort of regulatory agreements, to-wit corporate charters, that resulted in litigation of the unmistakability doctrine. The federal government simply did not charter very many corporations through special charters in the form of federal statutes. The exception that proves the rule is the *Sinking Fund Cases*, which demonstrate an early version of an unmistakability analysis (albeit applying only a weak interpretive presumption) post-dating *Deming* and *Jones*.

Schwartz does not discuss the *Sinking Fund Cases*. Nor does he discuss the fact that essentially all of the early state unmistakability cases involved corporate charters which included regulatory provisions. Over time, chartering bodies moved away from including regulatory provisions (which the government might later want to change) in corporate charters. This evolution, aided no doubt by the growth of the administrative state during the New Deal, better explains why there have been so few unmistakability cases on *either* the state or federal level following the New Deal. The relative paucity of federal unmistakability cases should not be considered evidence that the sovereign acts doctrine has been providing the federal government with the same or similar protection that the unmistakability doctrine has provided the states.

One more example should show that Schwartz's analysis probably holds back too much in its criticism of Souter's opinion in order to build synthesis. Schwartz argues that Souter is inconsistent in applying the Holmesian "recharacterization" of the regulatory agreements into promises to pay damages, because Souter applies the recharacterization in his analysis of the unmistakability, the reserved powers, and the express delegation doctrines, but does not do so in his analysis of the sovereign acts doctrine.<sup>498</sup> Schwartz correctly points out that if Souter had recharacterized the government's obligations at the outset of his sovereign acts analysis, this would have effectively rendered the doctrine "a nullity"<sup>499</sup> because the recharacterization would have led to the opposite result in *Horowitz*, which like *Winstar*, involved an arm of the federal government.<sup>500</sup> After all, if the Court in *Horowitz* had read the silk contract as a promise to pay damages, then the silk embargo could have been carried out and the contract could have been enforced.

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<sup>498</sup> See *id.* at 531-32.

<sup>499</sup> *Id.* at 531.

<sup>500</sup> See *id.*

This inconsistency makes sense, however, in light of the fact that the sovereign acts doctrine, unlike the other special defenses, does not purport to help construe the original agreement. Schwartz's ultimate criticism of this inconsistency is that it was "unnecessary" for Souter to both recharacterize the agreements in analyzing the first three defenses and then analyze the unmistakability doctrine anyway.<sup>501</sup> The better explanation for Souter's reluctance to explore the relationship between the defenses is that applying the sovereign acts doctrine directly would have lent too much strength to the distinction between the government's sovereign and private roles. This would have been inconsistent with Souter's lament that it is too difficult to contain the unmistakability doctrine to agreements made in the sovereign capacity, and would have suggested the need to retreat a step analytically and question whether a purely contractual analysis makes the most sense. Moreover, as argued above, Souter needed to set up his use of the impossibility doctrine to avoid the obvious consequences of the heavily regulated industry doctrine.

Schwartz's synthesis does little to increase the predictability of results in this area of the law because it is unclear what constitutes complete generality. Is the generality of *Perry*, where all holders of gold dollars and contracts with gold clauses were affected, the minimum required generality? A much lower level of generality appears in *Horowitz*, where the only persons affected by the ban on shipping silk were those either in the business of shipping silk or those who, like the plaintiffs, contracted for a delivery of silk at a certain date. If this is sufficient, then what is the lower threshold of generality that would still entitle the government to a weaker version of the unmistakability defense? The level of generality, of course, should be seen as a relative notion, comparing the scope of those affected by the subsequent breaching legislation or action with the scope of those who were parties to the original agreements. In this light, there is not a significant difference in the level of generality between *Horowitz* and *Winstar*.

Most problematically, neither Schwartz's analysis of the reasoning in *Winstar* nor his proposed synthesis adequately addresses the express delegation doctrine. Again, because Schwartz is aiming to construct the best reconciliation possible that incorporates *Winstar*, he cannot reject any of *Winstar*'s major premises, even where the opinions go fundamentally wrong. Justices Souter, Breyer, and Scalia all gloss over the express delegation doctrine and, more generally, the delegation issues inherent in an agency acting on behalf the government. Unfortunately, this leaves

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<sup>501</sup> See *id.* at 532.

Schwartz's analysis similarly devoid of any mention of delegation issues. For example, in analyzing Souter's argument that it would have been "madness" for the plaintiffs to have agreed to allow "the Government" to change the capital rules "at the Government's election,"<sup>502</sup> Schwartz echoes Souter's reasoning by concluding that it is more reasonable to find risk-shifting promises than "to construe the agreements as offering the plaintiffs *no protection against regulatory change*."<sup>503</sup> As argued above, it is quite possible that the agreements were intended to protect the plaintiffs against change initiated by the agencies but were silent with respect to congressionally required change.

Schwartz's analysis also misses the need for the distinction between the government's sovereign and private roles in order to make sense of the delegation issues implicit in fulfilling the requirements of the Anti-Deficiency Act<sup>504</sup> and the Appropriations Clause<sup>505</sup> of the Constitution. Schwartz critiques Rehnquist's concluding argument that the need to treat the government differently than private contracting parties arises from "the necessity of protecting the federal fisc—and the taxpayers who foot the bills—from possible improvidence on the part of the countless Government officials who must be authorized to enter into contracts for the Government."<sup>506</sup> Schwartz writes:

The analogy drawn by Chief Justice Rehnquist is, on its face, puzzling. . . . Presumably his concern is that an official may have authority to enter contracts but may lack the further authority to commit

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<sup>502</sup> *Winstar*, 518 U.S. at 910.

<sup>503</sup> Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 530 (emphasis added); *id.* at 485 (referring to "regulatory standards" without differentiating between regulations or statutes); *id.* at 526-27 (discussing the impossibility doctrine and assumption of risk by "party that did not perform" under the contract); *see id.* at 526-30 (discussing Souter's treatment of the sovereign acts doctrine); *id.* at 540 (discussing Scalia's treatment of the sovereign acts doctrine and the impossibility doctrine's "requirement that the party seeking exculpation not be responsible for the impossibility of performance"); *id.* at 543 (discussing Scalia's description of "illusory contract"); *see also id.* at 514-15 (analyzing Souter's treatment of the express delegation doctrine); *but see id.* at 564 (discussing the Anti-Deficiency Act, 31 U.S.C. § 1341 (1994)).

<sup>504</sup> 31 U.S.C. § 1341 (1994).

<sup>505</sup> U.S. CONST. art. I, § 9, cl. 7.

<sup>506</sup> Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 551 (quoting *United States v. Winstar Corp.*, 518 U.S. 839, 937 (1996) (Rehnquist, C.J., dissenting)).

the United States to compensate its contracting partners in the event of a change in generally applicable regulatory requirements.<sup>507</sup>

This concern should only appear puzzling as it relates to government contracts, i.e., to promises made in the government's private capacity. It is not at all clear that agencies have the power to commit the Treasury to pay damages for changes in regulatory policies as a part of the agencies' power to enter into regulatory agreements. Schwartz correctly points to *Hercules, Inc. v. United States*<sup>508</sup> as indicative of a major flaw in Souter's reasoning, for it strongly suggests that the courts should not "recharacterize" all government agreements as providing for indemnity for regulatory changes.<sup>509</sup> Unfortunately, Schwartz's analysis does not seem to recognize the breadth of this apparent exception to his proposed synthesis. The framework proposed below avoids this confusion by distinguishing between government contracts and regulatory agreements, and providing for an alternative grounds for enforcing regulatory agreements so as to avoid forcing the courts to decide between treating them as contracts or illusory promises.

In sum, Schwartz's analysis and proposed synthesis probably make as much sense out of *Winstar* as can be made. Given the deep flaws in the *Winstar* plurality's analysis and the hostility it heaps upon the administrative state, the better approach is to encourage the Court to correct the error that is *Winstar* and move on to a more coherent, balanced framework that is far more consistent with the rest of the Court's jurisprudence.

#### B. *A Proposed Framework for the Special Contract Defenses*

Such a framework should begin with determining the government's role—sovereign or private—when it made the original promise. When acting in a private capacity, the government should not benefit from the unmistakability or express delegation defenses at all. Instead, the agreements should be treated as private contracts, along a congruence theory. There should be no need for a "second promise" for typical

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<sup>507</sup> *Id.* at 551-52.

<sup>508</sup> *Hercules, Inc. v. United States*, 516 U.S. 417 (1996).

<sup>509</sup> See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 563-64. Schwartz clarifies that the Anti-Deficiency Act does not necessarily prohibit the outcome in *Winstar* because of the standing appropriation to pay judgments against the government. See *id.* at n.369 (citing 31 U.S.C. § 1304 (1994)).

procurement contracts. The government should be allowed to raise the sovereign acts doctrine for such contracts, since the doctrine specifically addressed instances where the government contracted in its private capacity and later faced a subsequent sovereign act that undermined performance of the earlier contract. For agreements made by the government in its sovereign capacity, the unmistakability and express delegation doctrines should apply. These doctrines were designed to address the special problems arising out of these kinds of agreements; the problem with these doctrines has always been finding a way to limit them to situations where they are appropriate. The express delegation doctrine deserves more attention than it has received given the government's increased reliance on administrative agencies.

A harder question is whether the sovereign acts doctrine should apply to promises made in the government's sovereign capacity. I conclude it could apply, though its application is not critical to the success of the framework. In any event, its application would not lead to the frequent release of the government from its regulatory agreements for the simple reason that when the government enters into regulatory agreements, subsequent, breaching legislation that is significantly broader in scope is very unlikely. Much more likely is the sort of targeted roll-backs in *Fletcher v. Peck*, in *Lynch*, and in *Winstar*. In addition, scrutiny of the government's intent in enacting the subsequent sovereign act should help here also.

Nearly all of the Supreme Court's decisions prior to *Winstar* are consistent with this framework, in part because they sometimes rely on the sovereign/private distinction. Unfortunately, the case law has been inconsistent in its use of the distinction for several reasons. First, it has never distilled the distinction down to a few factors that produce consistent results. Second, the jurisprudence has never clarified the relationship between the defenses and explained when each special defense should or should not apply. Finally, the case law has never provided an alternative theory for why a regulatory agreement should be enforced even if it is not (or not treated like) a private contract.<sup>510</sup> Similarly, commentary on the sovereign/private distinction focuses more on the inconsistency of its application than on the utility of the distinction. The commentary has

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<sup>510</sup> See, e.g., *United States Trust Co. v. New Jersey*, 431 U.S. 1, 17-18 and n.14 (1977) (raising the issue of how to determine if a statute gives rise to a contractual obligation binding the government, and resolving the issue by noting that the state conceded the point).

offered few alternative frameworks and little explanation for how the defenses ought to interact.

The next several sections describe the framework in more detail. First, the distinction between sovereign and private roles is explored. The distinction has arisen in several lines of cases but has been criticized by commentators and courts alike as hard to maintain. I suggest three factors that should resolve most questions, and then apply them to several of the harder cases. Second, the unmistakability doctrine is analyzed as it would apply within the framework. The fear that the unmistakability doctrine will encourage the government to spoil its reputation as a dependable contracting partner is exaggerated. Third, the express delegation doctrine offers a vital, yet overlooked role. The major concern behind the criticism of the distinction between sovereign and private roles is the fear that if the government's sovereign role is too broad, its agreements will not be treated as contracts and there will be no theory for their enforcement. The express delegation doctrine suggests grounds for enforcement of regulatory agreements based on the Administrative Procedures Act's prohibition on arbitrary and capricious agency actions. Finally, the sovereign acts doctrine is discussed in connection with the question of whether to apply it to agreements made in a sovereign capacity. When seen as part of this broader framework, Schwartz's proposal will make more sense, though I hope to persuade the reader that any sort of sliding scale approach is unworkable.

### *C. Distinguishing Between Sovereign and Private Capacities of Government*

The courts have relied on the distinction between the government's sovereign and private capacities in several other areas of law, suggesting that the distinction is not at all incoherent or untenable. Most notably, in deciding banking agency claims for enforcement of net worth maintenance agreements,<sup>511</sup> courts have relied on the distinction. This is true of the

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<sup>511</sup> For criticism of net worth maintenance agreements, see, for example, Jackson, *supra* note 23, at 518-28 (summarizing the history of agencies' use and enforcement of NWMAs); John C. Deal et al., *Capital Punishment: The Death of Limited Liability for Shareholders of Federally Regulated Financial Institutions*, 24 CAP. U. L. REV. 67 (1995) (arguing for an end to personal liability for capital maintenance); Carolyn J. Buck & Dwight C. Smith III, *Enforcement of Net Worth Maintenance Agreements and the Imposition of Civil Money Penalties*, 24 CAP. U.



several cases rejecting enforcement when the regulatory agencies sued on a contract theory,<sup>512</sup> and of the other line of cases where the agencies sued on a regulatory enforcement theory and achieved mixed results.<sup>513</sup>

In the first line of cases, the courts' analysis usually left much to be desired in terms of depth and clarity. For example, the court in *In re Conner Corp.*<sup>514</sup> upheld a bankruptcy court decision that a net worth maintenance agreement was not a contractual obligation but instead acquiescence to a regulatory requirement.<sup>515</sup> The court professed to distinguish between a contract and a regulatory obligation without relying on the presence or absence of bargaining: "If the terms of the agreement between Conner and the Bank Board were defined wholly by federal regulations instead of the give-and-take of negotiation, it is less likely that a contract was formed. The court is not saying that negotiation is an essential element of a contract."<sup>516</sup> The court later notes that the thrift owners agreed to maintain a five percent capital level even though that specific level does not appear in the regulations, but it seems that the absence of bargaining over the five percent level is the only indicia supporting the noncontractual classification:

Although th[e five percent] provision does not derive directly from the regulations and presumably was negotiable, the court does not believe that its inclusion is sufficient to transform this regulatory obligation into one that is also a contractual obligation. *The essence of the relationship* between the Bank Board and Conner is *wholly regulatory*. Conner applied, on behalf of Cardinal, for federal deposit insurance; the Bank Board responded by noting deficiencies in Conner's application and informing it of its options under the Insurance Regulations; Conner then agreed to comply with certain of these regulations. Nothing in this sequence of events evidences a mutual manifestation of intent to enter a contract. The inclusion of the five percent provision by the Bank Board is insufficient, by itself, to change what is essentially a regulatory relationship into a contractual relationship.<sup>517</sup>

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L. REV. 135 (1995) (responding to Deal's article).

<sup>512</sup> See, e.g., *In re Conner Corp.*, 127 B.R. 775 (E.D.N.C. 1991).

<sup>513</sup> See, e.g., *Wachtel v. United States Department of Treasury, Office of Thrift Supervision*, 982 F.2d 581 (D.C. Cir. 1993).

<sup>514</sup> *In re Conner*, 127 B.R. at 775.

<sup>515</sup> See *id.* at 780.

<sup>516</sup> *Id.* at 779.

<sup>517</sup> *Id.* at 780 (emphasis added).

Perhaps the best way to rescue the court from its confusion about the importance of bargaining is to emphasize the “regulatory relationship” between the parties. This is consistent with viewing contracts as agreements between legal equals, enforceable by virtue of their mutual assent, not by virtue of one party’s independent legal power over the other.

Similarly in *RTC v. Tetco, Inc.*,<sup>518</sup> court set forth a rather fuzzy distinction that ultimately depended on the presence or absence of specific bargaining over the net worth maintenance agreement:

[T]he net worth condition in the Resolution granting deposit insurance was a statement setting forth a regulatory condition. The net worth stipulation in the Simms letter was merely an acknowledgment and statement of assent to be bound by an *order* of the pertinent regulatory authorities. The terms of the net worth agreement and the regulatory approvals were never the subject of negotiations between the parties; their scope and effect were preordained to the letter by the regulations.<sup>519</sup>

The court went on to explain that the agencies had a regulatory enforcement scheme, under statute,<sup>520</sup> that would presumably allow for enforcement of the provisions.<sup>521</sup> The first line of net worth maintenance cases seem to have reached the right result ultimately, but lacked a persuasive theory for how to distinguish between a regulatory obligation and a contractual obligation. Bargaining is certainly not necessary for contract formation, and moreover, the regulatory approvals for these thrift mergers often involved extensive bargaining, of which the net worth maintenance provisions were a part. The distinction must lie in one party’s regulatory power over the other and the application of that power as a basis for the obligation’s enforcement.

This view of the net worth maintenance agreements is reflected in the other line of cases in which the government tried regulatory enforcement

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<sup>518</sup> *RTC v. Tetco, Inc.*, 758 F. Supp. 1159 (W.D. Tex. 1990), *vacated upon settlement*, 1992 WL 437650 (5th Cir. 1992) (citing *United States v. Munsingwear*, 340 U.S. 36 (1950)).

<sup>519</sup> *Id.* at 1162-63 (emphasis in original). The court went on distinguish the trial court decision in *Winstar*, which the RTC argued demonstrated that the regulatory approvals were contracts. The court reasoned that the supervisory goodwill promises amount to a commitment by the regulator not to look to the owners as a “source of strength.” *Id.* at 1164. This seems to fundamentally misunderstand the goodwill provisions.

<sup>520</sup> *See* 12 U.S.C. § 1818.

<sup>521</sup> *See RTC*, 758 F. Supp. at 1165.

theories. As mentioned above, the court in *Wachtel v. United States Department of Treasury, Office of Thrift Supervision*<sup>522</sup> denied administrative enforcement of a net worth maintenance agreement because the statute required an additional showing of unjust enrichment to support a restitution order. Earlier, the Court of Appeals for the Fifth Circuit reached the opposite result in *Akin v. United States Department of Treasury, Office of Thrift Supervision*.<sup>523</sup> In both cases, however, the courts viewed the provisions as regulatory conditions, not contracts. Enforcement turned on the scope of the agency's regulatory authority, not on the prior agreement of the parties. Indeed, neither case questioned the fact that the thrift owners had properly consented to the net worth maintenance conditions. Other net worth maintenance agreement decisions, arising in various bankruptcy disputes, are not inconsistent.<sup>524</sup>

A far more coherent body of law distinguishes between the government's sovereign role and its private role in interpreting the Federal Tort Claims Act ("FTCA").<sup>525</sup> Under the FTCA, the general rule for tort liability is a congruence rule: "The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or punitive damages."<sup>526</sup> But there is a very notable exception where the government acts in a sovereign capacity:

The provisions of this chapter and section 1346(b) of this title shall not apply to—

(a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or

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<sup>522</sup> *Wachtel v. United States Department of Treasury, Office of Thrift Supervision*, 982 F.2d 581 (D.C. Cir. 1993).

<sup>523</sup> *Akin v. United States Department of Treasury, Office of Thrift Supervision*, 950 F.2d 1180 (5th Cir. 1992).

<sup>524</sup> For example, in *In re Deltacorp, Inc.*, 111 B.R. 419 (Bankr. S.D.N.Y. 1990), the court enforced a net worth maintenance relying on super-priority provisions of 11 U.S.C. § 365(o). See also *Carlton v. Firstcorp*, 967 F.2d 942 (4th Cir. 1992) (holding that the bankruptcy court lacked jurisdiction to block a temporary cease-and-desist order under 12 U.S.C. § 1818 which sought compliance with NWMA). The court in *In re Securities Groups*, 116 B.R. 839 (Bankr. M.D. Fla. 1990), did treat the net worth maintenance provision as a contract, but then found the contract illegal for violation of restrictions on affiliate transactions.

<sup>525</sup> 28 U.S.C. § 2671 *et seq.* (1988).

<sup>526</sup> *Id.* § 2674.

regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a *discretionary function or duty on the part of a federal agency* or an employee of the Government, whether or not the discretion involved be abused.<sup>527</sup>

The line between the general rule and the “discretionary function” exception tracks the distinction between sovereign and private capacity. Courts have not had great difficulty defining a coherent line between the two roles.<sup>528</sup> For example, the court in *Waymire v. United States*<sup>529</sup> applied the discretionary function exception, despite arguments that it should not apply to government contract employees. The court reasoned: “First, ‘it is the nature of the conduct, rather than the status of the actor, that governs . . . . Second, the discretionary function exception ‘plainly was intended to encompass the discretionary acts of the *Government acting in its role as a regulator of the conduct of private individuals.*’”<sup>530</sup> The multitude of possible factual scenarios has not lead to disarray or a problematic lack of coherence to the FTCA’s discretionary function exception.

The sovereign versus private distinction has appeared in numerous other areas of the law as well, with roughly equal success as a coherent,

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<sup>527</sup> *Id.* § 2680 (1974) (emphasis added).

<sup>528</sup> *See, e.g., United States v. Gaubert*, 499 U.S. 315, 334 (1991) (holding there was immunity for FSLIC and FHLBB against a claim that their negligence destroyed the economic value of the plaintiff’s thrift); *United States v. Varig Airlines*, 467 U.S. 797, 814 (1984) (finding no liability on a state tort claim for the FAA when it delegated its aircraft inspections to manufacturer); *Golden Pacific Bancorp. v. Clarke*, 837 F.2d 509 (D.C. Cir. 1988) (holding there was immunity for the Comptroller’s decision to put the bank in receivership); *Starrett v. United States*, 847 F.2d 539 (9th Cir. 1988) (noting no immunity for the navy’s contamination of a missile site where the contamination violated the applicable environmental regulations); *cf. Berkovitz v. United States*, 486 U.S. 531 (1988) (rejecting the FDA’s claim of the exception where plaintiff alleged that the FDA acted in violation of its policy of testing all lots of vaccine prior to distribution). *See also Krent, supra* note 165, at 1533-34 (arguing that sovereign immunity is better understood as promoting majoritarian power and separation of functions, and that the FTCA discretionary function exception is consistent with these goals because discretionary functions are much more effectively checked by political processes than non-discretionary functions); *see id.* at 1545 n.57 (listing cases interpreting the standard for the discretionary function exception).

<sup>529</sup> *Waymire v. United States*, 629 F. Supp. 1396 (D. Kan. 1986).

<sup>530</sup> *Id.* at 1399 (quoting *United States v. Varig Airlines*, 467 U.S. 797, 814 (1984)) (emphasis added).

workable distinction. When the banking agencies serve as receiver for insolvent banks, the agencies act in a private capacity because the agencies' rights are based on the corporation's rights.<sup>531</sup> The Court recognized the private half of this dual role in two recent decisions involving the government receiver's rights. In *O'Melveny v. FDIC*,<sup>532</sup> the Court denied the government's claims that its role in regulating the banking system entitled the FDIC, as receiver, to special federal common law defenses not available under state law. Similarly, in *Atherton v. FDIC*,<sup>533</sup> the Court recognized that the FDIC, when acting as a receiver, stands upon what are essentially private causes of action and, in bringing these suits, does not act as a regulator when it sues bank insiders for negligence.

The Court in *South Carolina v. United States*<sup>534</sup> upheld a federal tax on the sale of liquor as applied to a state-owned and operated liquor stores. The Court reasoned that the state was acting in its private capacity in selling the liquor and so was therefore not entitled to the exemption from taxation recognized by early precedent.<sup>535</sup>

"Moreover, at the time of the adoption of the Constitution, there probably was not one person in the country who seriously contemplated the possibility of government, whether State or National, ever descending from its primitive plant of a body politic to take up the work of the individual or body corporate. . . ."

....

The Government was no competitor, nor did it assume to carry on any business which ordinarily is carried on by individuals.<sup>536</sup>

In distinguishing numerous cases granting states immunity from federal taxation, the Court wrote:

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<sup>531</sup> See, e.g., *Texas American Bancshares, Inc. v. Clarke*, 954 F.2d 329 (5th Cir. 1992).

<sup>532</sup> *O'Melveny v. FDIC*, 512 U.S. 79 (1994) (applying California common law, not federal common law, to the issue of defenses available to a law firm defending itself from the FDIC's tort claims as receiver for failed bank).

<sup>533</sup> *Atherton v. FDIC*, 519 U.S. 213 (1996) (applying the state common law standard of care for directors of a failed federally chartered thrift, where the common law standard is not more lenient than the federal statute's minimum standard).

<sup>534</sup> *South Carolina v. United States*, 199 U.S. 437 (1905).

<sup>535</sup> See *id.* at 459. The Court cited, *inter alia*, *The Collector v. Day*, 78 U.S. (11 Wall.) 113 (1871) (holding that Congress lacked the power to tax the salary of a state judicial official).

<sup>536</sup> *South Carolina*, 199 U.S. at 457-58 (quoting an earlier Court of Claims opinion) (39 Ct. Cl. 284 (1904)).

It is also worthy of remark that the cases in which the invalidity of a Federal tax has been affirmed were those in which the tax was attempted to be levied upon property belonging to the State, or one of its municipalities, or was a charge upon the means and instrumentalities employed by the State, in the discharge of its ordinary functions *as a government*.<sup>537</sup>

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These decisions, while not controlling the question before us, indicate that the thought has been that the exemption of state agencies and instrumentalities from National taxation is limited to those which are of a strictly governmental character, and does not extend to those which are used by the state in the carrying on of an ordinary private business.<sup>538</sup>

Similar reasoning appeared in *Cooke v. United States*,<sup>539</sup> discussed above, in which the Court found the government could not recover on forged commercial paper it had accepted and paid for when it did not find the forgery with reasonable speed but instead was negligently slow.

Laches is not imputable to the government, in its character as sovereign, by those subject to its dominion. . . . Still a government may suffer loss through the negligence of its officers. If it comes down from its position of sovereignty, and *enters the domain of commerce*, it submits itself to the same laws that govern individuals there. Thus, if it becomes the holder of a bill of exchange, it must use the same diligence to charge [fraud by] the drawers and indorsers that is required of individuals[.]<sup>540</sup>

The same distinction is implicit in the 1935 *Gold Clause Cases* in that the Court, both the majority and the dissenters, relied on different reasoning in two very similar cases. *Nortz v. United States*<sup>541</sup> involved gold clauses in government gold certificates which the Court found were equivalent to currency and subject to the same level of regulation. *Perry v. United States*<sup>542</sup> involved gold clauses in Treasury bonds, which the Court treated like private contracts. If there were no distinction in the nature of the original agreements—or in the government's role in entering into the

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<sup>537</sup> *Id.* at 459 (emphasis added).

<sup>538</sup> *Id.* at 461.

<sup>539</sup> *Cooke v. United States*, 91 U.S. 389, 398 (1875).

<sup>540</sup> *Id.* at 398 (citations omitted) (emphasis added).

<sup>541</sup> *Nortz v. United States*, 294 U.S. 317 (1935).

<sup>542</sup> *Perry v. United States*, 294 U.S. 330 (1935).

original agreements—there would have been no need to write separate opinions for these companion cases.<sup>543</sup>

1. *Suggested Factors for Distinguishing  
Between the Sovereign and Private Roles of Government*

The cases and commentary that distinguish between the sovereign and private roles of the government can be reduced to two factors. These factors enable courts to coherently determine whether agreements reached by a government agency should be treated as regulatory agreements or as private contracts. As discussed above, regulatory agreements would be enforceable only after the government has had the opportunity to raise the unmistakability and express delegation doctrines, and the government might get to raise the sovereign acts defense. Correspondingly, if the factors indicate that the agreement is akin to a private contract, the only special defense the government could raise is the sovereign acts doctrine.

The first factor simply applies the reasoning from *Home Telephone & Telegraph* and *AMTRAK* by looking for a legislative intent to contract in the language of the authorizing statute. If the statute uses language such as “contract” or “agreement” or “mutually agreeable terms,” then the agreements resulting from this authority should be treated as contracts. The proposed framework would then, somewhat redundantly, label this an example of the government acting in a private capacity, without resort to the second factor. If the statute does not show a clear intention to contract, then this factor will be insufficient by itself. It should be clear by now that the test from *Home Telephone & Telegraph* and *AMTRAK* elides the role of the agency in reaching the agreement. Where an agency is involved, the situation is complicated by the possibility that the agency seeks to bind itself to a regulatory agreement without binding the sovereign. This is the strength of the second factor.

The second factor begins by asking whether the agency, in reaching the agreement, acted pursuant to a statutory mandate to regulate the private party to the agreement. The alternative is that the agency does not regulate the private party, but reached an agreement with it as a necessary adjunct to its regulatory mission. Illustratively, hiring employees or leasing office

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<sup>543</sup> See also *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 144-48 (1982); *Illinois Cent. R.R. v. Illinois*, 146 U.S. 387 (1892), *aff'd* by *United States v. Illinois Cent. R.R.*, 154 U.S. 225 (1894); *Hughes Communications Galaxy, Inc. v. United States*, 998 F.2d 953, 958 (Fed. Cir. 1993) (holding that the unmistakability doctrine was designed for the government in its sovereign capacity).

space are private contracts, while agreeing to allow certain rates for utility companies are regulatory agreements. Professor Schwartz, in analyzing the Court's decision in *POSSE* finds this distinction helpful:

Somewhat more helpful may be the observation that the contractual provision [in *POSSE*] abrogated was an integral part of "a regulatory program" which "Congress retained authority to amend in the exercise of its power to provide for the general welfare. . . ." In distinguishing *Lynch* and *Perry*, the Court's opinion suggests a distinction between conventional contracts that have private analogues, such as a contract to repay borrowed money or to provide insurance in return for payment of a premium, and uniquely governmental contracts that are integrally intertwined with a regulatory or social service program of the government, such as the section 418 agreements. . . . Such a distinction has great practical importance; federal agencies may enter contracts as part of the administration of their uniquely governmental regulatory responsibilities that do not resemble typical private contracts. . . . The agreements in *Winstar* appear to fall into this category.<sup>544</sup>

The difficulty presented by this factor is selecting the level of scrutiny with which to determine the limits of the agency's regulatory power. Fortunately, the decision will not present the sort of question *Wachtel* presents of whether an agency has any power to perform the disputed action. The question, instead, should be more focused on which authority the agency relied upon: its regulatory powers specific to the counterparty, or its corporate powers more generally employable with various counterparties? The factor thus focuses more on the relationship between the two parties to the agreement.

Professor Speidel's insights fit neatly here as well:<sup>545</sup> if the breaching action or regulation is caused by a different agency than the agency that entered into the original agreement, the government's role in making the original agreement was almost certainly private. Otherwise, the second agency would not only share regulatory authority over the counterparty, but its regulations would trump those of the agency making the original agreement. While this may be possible, it should be rare. Under this framework, therefore, the government, whether sued through the first or

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<sup>544</sup> Schwartz, *Liability for Sovereign Acts*, *supra* note 13, at 686 (citations omitted).

<sup>545</sup> See Speidel, *supra* note 298.



second agency, could raise the sovereign acts doctrine as a special contract defense. Under the sovereign acts doctrine's intent analysis, it seems unlikely that the government sought to take advantage of the second agency's regulatory authority to relieve the government of the contract made by the first agency.

The inverse of the second factor appears in situations where the government faces market risks in seeking to reach the agreement. Has the government "come down from its position of sovereignty,"<sup>546</sup> and in so doing accepted the risks that no one will want to do business with it? Other indicia are whether the government must compete with other buyers or sellers, and whether the government derives a financial benefit from the competition of others. A good example of government choosing to enter the marketplace is the space shuttle program. The court in *Hughes Communications*<sup>547</sup> viewed the program as a private enterprise: "The United States government was then promoting commercial use of its shuttle fleet by private industry to offset the costs of its space program. To further this goal, NASA actively marketed its shuttles as launch vehicles for commercial payloads to both domestic and foreign users."<sup>548</sup>

One must be careful in applying this factor not to require a profit motive per se. In this vein, language from *Lynch* is illuminating:

True, these contracts, unlike others, were not entered into by the United States for a *business purpose*. . . . In order to effect a benevolent purpose heavy burdens were assumed by the Government. But the policies, although *not entered into for gain*, are legal obligations of the same dignity as other contracts of the United States and possess the same legal incidents.<sup>549</sup>

When hiring a private contractor, the government may benefit from competition and save money for the taxpayer. It may even sell liquor or lottery tickets to make money in a certain "business" sense. But focusing on the profit is probably misleading. The government may benefit from competition without a "business purpose" and when it does, it is likely to assume market risks, including high prices and low supply. These situations describe government's business, or private contracting role.

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<sup>546</sup> *Cooke v. United States*, 91 U.S. 389, 398 (1875).

<sup>547</sup> *Hughes Communications*, 998 F.2d at 955 (Fed. Cir. 1993).

<sup>548</sup> *Id.*

<sup>549</sup> *Lynch v. United States*, 292 U.S. 571, 576 (1934) (emphasis added).

Ultimately, this inverse of the second factor is less determinative than looking at the scope of the agency's regulatory authority. After all, the state unmistakability cases, especially the local utility cases, could be seen as examples of both regulation and market risk. The difficulty in these cases arises from the fine distinction between, for example, a city chartering a company to provide water for its residents, and the city purchasing water to resell to them. In both cases, the city runs a market risk that no one will accept a charter if the city prices the maximum rates too low. It makes more analytical sense to conclude that there are elements of both governmental roles in this relationship between the city and the utility companies. The proposed framework, however, looks for the presence of a significant sovereign role; it does not insist on characterizing the role as purely sovereign or purely private.

There are two other factors that appear in the cases and commentary, but these tend to muddy the issue and so should not be used. The presence or absence of bargaining should not control the finding of a private contract as opposed to a regulatory agreement. The net worth maintenance agreement cases illustrate the difficulty with reliance on bargaining as a test. Similarly, the adequacy of consideration should not be a factor. The notion that bargains need to include mutuality of promises is simply not consistent with regulatory agreements, such as enforcement orders (or even criminal plea bargains) where the government's actions are essentially one-sided precisely because it is exercising sovereignty over the counterparty. *Groos* correctly rejected a challenge to a net worth maintenance agreement for lack of consideration.

Conversely, a good example of the confusion that the search for consideration can cause appears in *Rapaport v. United States Department of Treasury, Office of Thrift Supervision*,<sup>550</sup> which struck down a cease-and-desist order requiring compliance with a net worth maintenance agreement. The OTS argued that the agency's approval of deposit insurance constituted consideration for the regulatory approvals. The agency was not arguing for the existence of the agreement, but instead for the value to the thrift owner of the approval, in order to support its claim of unjust enrichment. Deposit insurance should satisfy common law standards for consideration, but the court rejected the argument because the benefit did not meet a different common law standard, i.e., that of unjust enrichment. Consideration is probably present in some sense in most regulatory agreements, but that is

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<sup>550</sup> *Rapaport v. United States Dep't of Treasury, Office of Thrift Supervision*, 59 F.3d 212 (D.C. Cir. 1995), *cert. denied*, 516 U.S. 1073 (1996).

not always the sort of mutuality envisioned by contract law. Moreover, the issue is less whether the agreements should be enforced than on what theory and subject to which defenses and remedies.

Criticism of the distinction between the sovereign and private roles of the government has focused on the difficulty in making the distinction coherent and predictable, not on the need to make the distinction in order to establish a broader framework of special defenses. Professor Arthur Miller criticized the distinction as breaking down but did not explore the legal implications of the breakdown.<sup>551</sup> Miller's critique focused more on the use of contractual conditions as a means of implementing social policy. His analysis therefore makes no attempt to define the distinction legally or to criticize the test itself. J.D.B. Mitchell first endorsed the distinction, but later reconsidered and found that it broke down.<sup>552</sup> In the latter article, Mitchell argues that the several categories of governmental action (i.e., police power, taxation power, rate regulation, eminent domain, reserved power) are coherent predictors of when the courts will uphold the breaching action.<sup>553</sup> Mitchell's reliance on the categories of police power (among others) are subject to the same, if not worse, boundary problems, especially on the federal level. A deeper problem with this reasoning as a basis for criticizing the distinction between sovereign and private roles is that it looks to the wrong governmental action. The nature of the subsequent governmental action says little about the nature of the initial agreement. Mitchell directly criticizes many of the unmistakability cases, saying that "the operation by the municipality of a public utility undertaking whether of water supply or telephones must surely be in

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<sup>551</sup> See Arthur S. Miller, *Administration by Contract: A New Concern for the Administrative Lawyer*, 36 N.Y.U. L. REV. 957 (1961).

<sup>552</sup> Compare Mitchell, *A General Theory*, *supra* note 286, at 83 (endorsing the distinction); with Mitchell, *The Treatment of Public Contracts*, *supra* note 65, at 210-11 (criticizing it). For a historically interesting, but not particularly persuasive, version of the critique, see Delmar W. Doddridge, *Distinction Between Governmental and Proprietary Functions of Municipal Corporations*, 23 MICH. L. REV. 325 (1925). Doddridge analyzes six areas of law that make the distinction, finding that it is workable in three. Of the three where he finds the distinction wanting, his strongest argument is an analysis of several tort cases where immunity was denied even though the government's role appeared public. His critique can be fully answered, however, by noting that the line may be drawn more liberally in torts than in contracts without any logical inconsistency, and he seems to recognize this. See *id.* at 336.

<sup>553</sup> See Mitchell, *The Treatment of Public Contracts*, *supra* note 65, at 210.

[government's] proprietary capacity."<sup>554</sup> More fundamentally, Mitchell does not address how the failure to make the sovereign/private distinction will undermine coherence in the broader jurisprudence of regulatory agreements.

Perhaps the strongest critique is that of Professor Janice Griffith.<sup>555</sup> One of her primary examples of the difficulty in making the distinction is a comparison of two similar cases that reached opposite results. Both involved municipalities that agreed to provide sewer services to people outside their jurisdictions on the same terms and conditions as they provided the services to their residents.<sup>556</sup> In *Copper Country Mobile Home Park v. Globe*,<sup>557</sup> the municipality subsequently raised the rates of the nonresidents above the rates it charged residents. The Arizona Supreme Court found the agreement a private contract and held the municipality liable for breach. In *Barr v. City Council of Augusta*,<sup>558</sup> the municipality enacted an assessment upon the nonresidents and the Georgia Supreme Court upheld the new rates, rejecting the contract claim as an infringement on the sovereign power of the municipality. The results can be reconciled under the proposed analysis: The fact that the Augusta residents in *Barr* did not challenge the subsequent assessment indicates that Augusta probably had some sovereign power over the sewer users all along and thus their agreement would have implicated the sovereign role of the city. By contrast, the city in *Globe* presumably lacked sovereign power over the non-residents and so could only affect rates with their consent, i.e., via contract. Therefore, *Globe* could not raise the unmistakability defense.

Given the multitude of state court decisions Griffith proposes to reconcile at face value, without criticizing individual results, it is not surprising that her proposed test is an extremely flexible five-factor test. All five elements must be met in order to enforce the contract: (1) there was no bad faith or fraud involved in formation of the contract; (2) the contract does not undermine the political process; (3) the contract advances a governmental interest that outweighs the loss of governmental control; (4) the contract restrains governmental operations only as far and long as necessary; and (5) the historical context has not changed so much that

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<sup>554</sup> *Id.* at 228.

<sup>555</sup> See Griffith, *supra* note 43, at 277.

<sup>556</sup> See *id.* at 285 n.25.

<sup>557</sup> *Copper Country Mobile Home Park v. Globe*, 641 P.2d 243 (Ariz. Ct. App. 1982).

<sup>558</sup> *Barr v. City Council of Augusta*, 58 S.E.2d 820 (Ga. 1950).

enforcement would work substantial harm to public.<sup>559</sup> The plasticity of elements (3) and (4) strongly resembles the means-ends nexus analysis put forth by the Supreme Court in *Spannaus* for interpreting the Contracts Clause. The other elements, while not sufficient by themselves to constitute a useful framework, are sound. The last, catch-all element should not be immediately dismissed. Changing historical circumstances have appeared as the rationale behind many major Supreme Court decisions, from *Charles River Bridge* to *Brown v. Board of Education*,<sup>560</sup> and it does have a certain built-in limitation on the frequency of its use. I argue below that it should be employed as a last-ditch escape for the sort of giveaways that survive a generation and come to shock the conscience of the next generation.

## 2. *Conventional Wisdom Has No Theory for the Enforcement of Regulatory Agreements Other than Private Contract Theory*

In *Charles River Bridge*,<sup>561</sup> the Court briefly raised the issue of whether the plaintiff's original charter constituted a contract under state law but then side-stepped the issue:

[Plaintiffs] must show that the title which they claim was acquired by contract . . . . The nature and extent of the ferry right granted to Harvard College in 1650 must depend upon the laws of Massachusetts . . . . But in the view which the court take of the case before them, it is not necessary to express any opinion on these questions. For, assuming that the grant to Harvard College, and the charter to the bridge company, were both contracts, . . . , still they cannot enlarge the privileges granted to the bridge[.]<sup>562</sup>

The Court thus treated the charters as contracts, apparently for lack of an alternative theory. This theme runs through most of the cases discussed herein to some degree. Declaring that the regulatory agreement is not a contract raises the difficult question of whether it can be enforced against the government in any way. After all, if the courts do not treat the government as a legal equal, then it seems counterintuitive to allow the regulated entity to require certain actions of the sovereign.

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<sup>559</sup> See Griffith, *supra* note 43, at 285-86.

<sup>560</sup> *Brown v. Board of Educ.*, 349 U.S. 294 (1955).

<sup>561</sup> *Charles River Bridge Co. v. Warren Bridge Co.*, 36 U.S. (11 Pet.) 420 (1837).

<sup>562</sup> *Id.* at 540-41.

This same fear—that calling regulatory agreements something other than contracts will leave them completely unenforceable—probably explains why the *Winstar* plurality prefaces its lengthy opinion with one brief paragraph noting that it has ignored the underlying issue of whether the acquisition approvals constituted contracts at all: “The anterior question whether there were contracts at all between the Government and respondents dealing with regulatory treatment of supervisory goodwill and capital credits, although briefed and argued by the parties in this Court, is not strictly before us.”<sup>563</sup> As discussed in Part I, a lengthy discussion of whether regulatory agreements constitute contracts would have raised too directly the issue of whether they should be scrutinized under a due process analysis as opposed to contractual analysis.<sup>564</sup> The contracts analysis flows coherently once chosen; the deeper issue is, of course, when contractual analysis should govern.

This same pressure to treat regulatory agreements as contracts runs through most commentary as well. Typical is this criticism of the sovereign/private distinction written by Professor Griffith:

The most widely adopted test distinguishes between a municipality’s governmental and proprietary activities. This test is based upon the nineteenth-century view that a local government is both a private corporation that engages in proprietary actions and a public entity that performs governmental functions. A municipality that contracts in furtherance of its proprietary powers—acting in effect as a private party—is *obligated to perform* the contract. On the other hand, a municipality that contracts with respect to a governmental function is *not bound* because public powers may not be contracted away or removed from public control.<sup>565</sup>

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<sup>563</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 860 (1996) (citations omitted).

<sup>564</sup> Another example of this concern appears in *Columbus Railway, Power & Light v. Columbus*, 249 U.S. 399 (1919), where the company sought to abandon its franchise on the grounds that it had become unprofitable. The city objected and argued that it had chartered the company while acting in its *private* capacity. The company argued the charter was “legislative” and therefore it granted only rights, not obligations. *See id.* at 407. The Court found for the city, reasoning that the charter was indeed a contract. *Cf.* *Los Angeles v. Los Angeles Gas & Elec. Co.*, 251 U.S. 32 (1919) (finding the company’s franchise to have been granted by the city acting in its proprietary capacity and holding the charter enforceable against the city, which sought to remove the company’s existing lighting systems prior to expiration of the franchise without compensating the company).

<sup>565</sup> Griffith, *supra* note 43, at 284 (emphasis added).

Like most commentators, Griffith does not propose an alternative theory of enforcing a regulatory agreement other than private contract law. Without an alternative theory, the decision not to treat regulatory agreements as contracts leaves the agreements as illusory promises, creating enormous pressure on the courts to treat regulatory agreements as contracts. Unfortunately, this confuses the applicability of the unmistakability doctrine because it blurs the helpful distinction between regulatory agreements and government contracts.

If municipal governments or government agencies were held to their agreements under another theory, apart from private contract law or a modified version thereof, there would be no need to fear a finding that the regulatory agreement is not an ordinary contract, just as there would be no need to conclude that government's promises are revocable at will. Far from pushing toward the result of illusory promises, the distinction between the government's sovereign and private roles would clarify the rationale for enforcing government's agreements. When acting as a sovereign, the government should be allowed to raise the unmistakability doctrine. Under the proposed framework, the government would first have to demonstrate that the original agreement related not to private contractual matters, but instead to the government's use of its regulatory powers. Thus, the government would need to show that the actions at issue were subject to the direct regulatory control of the government's sovereign power, and that, therefore, the government's use of the defense would not spillover into other situations more akin to typical procurement contracts.

Moreover, in the case of a federal agency, its regulatory agreements could easily be enforced on a modified version of "arbitrary and capricious" review under the Administrative Procedures Act: if the agency makes an unmistakably clear promise not to change its regulatory treatment of the counterparty, but then later changes its regulation of the counterparty in the absence of a congressional mandate to do so, the new regulation could be struck down as beyond the agency's remaining authority. The APA remedy—an injunction—would not run afoul of the Anti-Deficiency Act or the Appropriations Clause as interpreted by *Office of Personnel Management (OPM) v. Richmond*.<sup>566</sup> In this way, agreements made by an agency relating to regulatory decisions within the agency's control and discretion would be binding, not illusory promises.

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<sup>566</sup> *Office of Personnel Mgt. (OPM) v. Richmond*, 496 U.S. 414 (1990) (holding that claims for money against the government are saved by the Appropriations Clause if there is no statutory basis for paying out the money).

This theory of enforcement better accounts for the statutory and constitutional context in which administrative agencies operate. Agencies frequently act within a wide range of discretionary options given to them by broad or vague statutory language. Judicial recognition of the breadth of the authority granted by any particular language should eventually make clear that Congress sometimes passes the buck to the agencies to make politically difficult decisions. Exercising discretion given to them by Congress, agencies generally act with the knowledge that Congress could effectively veto their actions either through direct legislation or, less effectively but more readily, through its oversight functions. Just as with the sovereign legislature, an administrative agency should be allowed to make agreements concerning the exercise of its sovereign authority, but with the same protection from giving away its sovereign authority by implication. In light of the fact that government rarely makes agreements directly, i.e., through statutes, but frequently makes agreements through administrative agencies, it makes sense to have some predicate for the enforceability of regulatory agreements. As long as that basis recognizes the relationship between the parties is not that of legal equals, and that the governmental party needs to retain its sovereign authority in order to carry out its primary mission of representing the will of the majority, there is no difficulty. Other than recognizing the unmistakability doctrine and limiting the remedy to an injunction, this theory of enforcement of regulatory agreements need not look much different than contract law.

### 3. *Reconciling the Recommended Factors with Supreme Court Precedent*

Despite the different rationale behind this framework as compared to either existing case law or the proposals of various commentators, it is consistent with nearly all Supreme Court decisions regarding regulatory agreements, except *Winstar*. This section discusses a few of the more salient decisions.

Historically, the distinction between the government's sovereign and private roles has experienced the most difficulty in the municipal utility cases. In the typical case, the city is both acting in its sovereign capacity and taking market risks that it will have to change the terms of the charter. Where the sovereign acts directly, the textual analysis from *Home Telephone & Telegraph* and *AMTRAK* should suffice, as it has for the Court's economic due process jurisprudence. The search for legislative intent to be bound by contract rationalizes the state unmistakability cases, discussed in Part I, because the statutes in these cases do not require



agreement or consent, but instead authorize the municipality to fix, set, or regulate rates. The relationship between the chartering entity and the corporation is not that of legal equals. This holds true for the cases like *Charles River Bridge* and the *Sinking Fund Cases* where the sovereign itself grants the charter, and also for cases like *Rogers Park* and *Home Telephone & Telegraph* where a municipality grants the charter relying on authority delegated to it by the sovereign. Even under the second factor, the municipalities are exercising their limited authority to charter utility companies. It is less likely that if the government takes no market risks the counterparties will reject the charter, but the presence of the regulatory authority should suffice. After all, the government could be seen as taking a market risk in using tax policy to encourage certain social outcomes when it has not set the tax break or penalty high enough to achieve its ends, but even Justice Souter would agree that taxation is always a sovereign act. The more important element is the presence of direct regulatory authority, rather than the presence of market risk facing the government.

The utility congruence cases are generally consistent with the proposed framework as well. For example, in *Detroit Citizens'*,<sup>567</sup> in which the Court blocked the new rates, the relevant statutes required cities to issue franchises "upon such terms and conditions as may be agreed upon by the company and the township[.]"<sup>568</sup> Therefore, under the reasoning of *Home Telephone & Telegraph* and *AMTRAK*, the state's intention to be bound by contract is made plain by the requirement of consent of both parties. The state has come down from its position of sovereignty and requires treatment of its municipality as a legal equal in this instance.

In *Los Angeles City Water*, the authorizing statute gave the city the power to "regulate" water rates.<sup>569</sup> This statute evinces a clear intention by the legislature not to treat the utility charters granted under it as contracts. Nevertheless, one could apply the second factor and reach the same result. The agreement relates to regulation of rates, so it is an example of the city acting in a sovereign capacity. The city later changed the rates, but the Court blocked application of the new rates to the plaintiff because the charter, with unmistakable clarity, "provided that they [i.e., the mayor and the city council] shall not so reduce such water rates or so fix the price thereof as to be less than those now charged by parties of the second part for water."<sup>570</sup> The city could have raised the unmistakability defense in *Los*

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<sup>567</sup> *Detroit v. Detroit Citizens' St. Ry.*, 184 U.S. 368 (1902).

<sup>568</sup> *Id.* at 373.

<sup>569</sup> *See Los Angeles v. Los Angeles City Water Co.*, 177 U.S. 558, 560 (1900).

<sup>570</sup> *Id.*

*Angeles City Water* because the regulatory agreement was an exercise of its sovereign power. The unmistakably clear language, however, would have meant that the defense would not have won the case for the city. It should be noted as well that the remedy in *Los Angeles City Water*, as in the other utility congruence cases, was an injunction blocking application of the new rates,<sup>571</sup> not damages as *Winstar* would have provided.

Perhaps the only utility congruence case that would be reversed by the proposed framework is *Cleveland City Railway*. In that case, the railroad company had gone through several mergers, approved by various ordinances. The company's original charter included a reservation of authority to change rates, but subsequent ordinances approving combined charters omitted the reservation of authority. The statutes, however, did not at all speak in terms of contracting with the railroads: "[The City] Council . . . shall have the power to *fix* the terms and conditions upon which such [street] railways may be constructed, operated, extended, and consolidated."<sup>572</sup> The Court quoted from the ordinance's language on rates: "no greater charge than 5 cents shall be collected,"<sup>573</sup> and then gave as its most conclusive reason the lack of an applicable reservation of authority: "In reason, the conclusion that contracts were engendered would seem to result from the fact that provisions as to rates of fare were fixed in ordinances for a stated time and no reservation was made of a right to alter [them]."<sup>574</sup> The Court declared *Detroit Citizens'* as controlling, even though it would seem to indicate a contrary result.<sup>575</sup> *Cleveland City Railway* appears to be the only Supreme Court decision, other than *Winstar*, that the proposed framework would reverse, but it should be noted that the error of *Cleveland City Railway* is plain even within the jurisprudence of its own era.

The more recent unmistakability cases are perfectly consistent with the proposed framework and the distinction between sovereign and private roles. The sovereign role of the government is clear in *POSSE*, where the agreements at issue governed administration of social security benefits. The government exercised direct regulatory control over the counterparties,

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<sup>571</sup> *See id.* at 583.

<sup>572</sup> *Cleveland v. Cleveland City Ry.*, 194 U.S. 517, 534 n.1 (1904) (emphasis added). The statutes also barred the city from permitting the railways to raise their rates upon extensions of the lines, suggesting that the power to reduce rates might be reserved.

<sup>573</sup> *Id.* at 535.

<sup>574</sup> *Id.* at 536.

<sup>575</sup> *See id.*

even though they were public agencies, because these agencies were subject to the federal government's power to enact binding regulations, just as private employers are.<sup>576</sup> Similarly, in *Merrion*, the government acted as sovereign because the agreement at issue—the sale of a riverbed—involved the government's constitutional power to regulate navigable waterways.<sup>577</sup> It is interesting to compare *POSSE* and *Merrion* to *Appleby v. Delaney*.<sup>578</sup> In *Appleby*, the state contracted to sell tidewater land, later acquired by plaintiffs. As construed by the New York state courts in a prior lawsuit, the deed's covenants permitted owners to fill most of the land without the city's permission, and the Court in *Appleby* struck down the city's ordinance preventing the filling of the land.<sup>579</sup> The state in *Appleby* lacked the underlying constitutional authority to regulate the land. Nevertheless, it is unclear why the Court did not apply the unmistakability doctrine since the Court did not seem to question the city's authority to regulate construction at the site, other than by pointing to the contract. In any event, the original sale in *Appleby* was made by the state in its private capacity.

The government acted in its private capacity in making each of the agreements in the three landmark sovereign acts doctrine decisions. In *Deming*, the agreement was a contract to provide food for the Union army. In *Jones*, the government hired individuals to survey wilderness land. In *Horowitz*, the government contracted to sell surplus silk at a certain date, place, and price. In each case the government entity making the contract did not have regulatory authority over the counterparty, and it therefore assumed the market risk that no one would agree to the government's terms. It would have been needlessly protective of sovereign authority in these cases to allow the government to raise either the unmistakability or express delegation doctrines.

This same private role appears in *Fletcher v. Peck*,<sup>580</sup> where the Georgia legislature sold huge tracts of land to speculators. Under the proposed framework, the state would be allowed to raise the sovereign acts doctrine but would lose because the revocation was specifically targeted at revoking the original bargain. *Fletcher* is better seen as a takings case

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<sup>576</sup> Of course, *POSSE* raises federalism issues that went unaddressed by the Court.

<sup>577</sup> See also *United States v. Citizens & Southern Nat'l Bank*, 889 F.2d 1067 (Fed. Cir. 1989) (holding that a federal agency's selection of a national bank as a public depository was use of its sovereign authority, not a contract).

<sup>578</sup> *Appleby v. Delaney*, 271 U.S. 403 (1926).

<sup>579</sup> See *id.* at 414.

<sup>580</sup> *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810).

because there was no longer an operative contract after the land had been sold. The Court treated the “executed contract” just as an “executory contract,” i.e., one that has yet to be fulfilled by the parties, probably because the Takings Clause of the Fifth Amendment had not yet been incorporated against the states, as it now has. As discussed below, *Fletcher* also illustrates the need to coordinate the law of special government contract defenses with takings law, so as to avoid creating pressure on the definitional differences between the two claims.

The courts have more directly faced the issue of the government’s role in cases involving municipal and other kinds of bonds. Under the proposed framework, municipal bonds are private contracts because government has no regulatory authority over the purchasers of the bonds simply because they have purchased the particular bonds. Moreover, the government entity is entering the market and exposing itself to the market risk of undersubscription (or conversely, underpricing). In *United States Trust Co. v. New Jersey*,<sup>581</sup> the Port Authority of New York and New Jersey floated bonds backed by the revenues and reserves of the Port Authority. Identical statutory provisions enacted in 1962 in New York and New Jersey prevented the Port Authority from diverting the pledged funds to subsidize passenger rail transit. Then, in 1974, the states repealed the bar retroactively and a bondholder brought suit. The Court struck down the repeal, based on the Contracts Clause.<sup>582</sup> The Court nodded to the reserved powers doctrine, finding it bound up in “formalistic distinctions,” but nevertheless allowing “financial contracts” even though they might also infringe on a police power: “[T]he States are bound by their debt contracts.”<sup>583</sup> The Court did not define debt contracts, nor attempt to distinguish them from agreements regarding taxation. But in a footnote the Court elaborated on the government’s role: “The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons.”<sup>584</sup> This language probably came from the earlier decision in *Cooke*, which treated the federal government like a

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<sup>581</sup> *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977).

<sup>582</sup> *See id.* at 32.

<sup>583</sup> *Id.* at 24.

<sup>584</sup> *Id.* at 25 n.23 (quoting *Murray v. Charleston*, 96 U.S. 432 (6 Otto), 445 (1877)).

private contractor when it accepted forged commercial paper.<sup>585</sup> In both *United States Trust* and *Cooke*, the government set aside its role as sovereign and met the bond-purchasers as legal equals. The state did the same thing in *South Carolina v. United States*<sup>586</sup> by entering into the business of selling liquor to retail customers.

At least two local bond cases do not fit the pattern as neatly. In *Keefe v. Clark*,<sup>587</sup> the Court upheld a statute that rolled back a similar backing to drainage district bonds. The state originally authorized the drainage district to issue bonds and required districts to levy assessments on the covered lands if necessary to pay the bonds in full. Later, the state passed another statute allowing for the sale of lands encumbered by such assessment, but the buyer would take encumbered title. Bondholders sued, but the Court denied their claim. The Court applied a strict construction, essentially an unmistakability presumption, citing the need to avoid restricting the state's sovereignty.<sup>588</sup> The *Keefe* decision, which predated *United States Trust*, seems incorrect. The flaw in the Court's analysis, not surprisingly, appears in its description of the sovereign power at issue:

Emphasizing the serious consequences of such a hobbling of the State's powers to meet pressing problems, the [state supreme] Court pointed out that the power of the State to sell tax-delinquent lands free of the burden of assessments for completed drain projects was essential not only to protect the bondholders themselves but to protect the public interest. Without power in the State to offer an attractive title to prospective

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<sup>585</sup> See *United States Trust Co.*, 431 U.S. at 28-32, where the Court applied a means-end nexus analysis similar to that in *Blaisdell* and its later decision in *Spannaus*. Under this analysis, the Court found that the repeal was not reasonably necessary to serve an important public purpose. See also Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 490 n.35.

<sup>586</sup> *South Carolina v. United States*, 199 U.S. 437 (1905) (upholding a federal tax on the sale of liquor by a state-owned seller). See also *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935) (striking down a law which so restricted creditor remedies against municipal bonds as to make the bonds worth very little); *W.B. Worthen Co. v. Thomas*, 292 U.S. 426 (1934) (striking down on Contracts Clause grounds a state statute that exempted life insurance proceeds from judicial process). In the *Sinking Fund Cases*, the Court upheld new restrictions on bonds floated by the government to subsidize the railroads, but the statutes authorizing the bond specifically reserved the power to Congress to amend the provisions of the statute. See *Central Pacific Ry. v. Gallatin*, 99 U.S. 700 (1879).

<sup>587</sup> *Keefe v. Clark*, 322 U.S. 393 (1944).

<sup>588</sup> See *id.* at 397.

purchasers, the Court found, many of such lands would remain tax-delinquent and thereby be rendered valueless for all public revenue purposes, including drain assessments.<sup>589</sup>

In other words, the only two sovereign interests at stake were: (1) the ability to sell any land so as to pay off bondholders at least in part, and (2) "public revenue purposes." Neither of these interests amounted to a regulatory interest. Indeed, it is clear that the bondholders were in no way regulated by the state or the drainage districts, and that the state's real interest in passing the subsequent legislation was simply to relieve itself of the financial strain.

Less problematic is the Court's decision in *Faitoute Iron & Steel Co. v. Asbury Park*,<sup>590</sup> which upheld a law that extended maturity of the city's bonds by thirty years and reduced the bond's coupon rate. Two factors make the case reconcilable with the proposed framework. First, the reduced obligations were authorized pursuant to a state reorganization statute which the Court concluded did not improperly infringe on federal bankruptcy powers. Second, the bonds were not backed by a specific project or property but were general obligation bonds effectively backed by the city's taxation authority.<sup>591</sup> This makes the bonds look a little less like a method by which the city entered the marketplace for funds for a specific project. It is also true that making good on such bonds during fiscal hard times would affect the city's sovereign powers. But making an exception for general obligation bonds places too much emphasis on the specific backing for the bond. Under the proposed framework, the city is entering the market for funds and taking the market risks that the bonds will be undersubscribed or underpriced; the city does not regulate the bondholders as such. *Faitoute Iron* is better understood as an example of the permissible reach of state bankruptcy laws under an old bankruptcy regime.

Most commentators see the Court's decision in *Lynch* as standing for a congruence ideal in government contracting.<sup>592</sup> In *Lynch*, the government provided as a benefit to veterans of World War I life insurance underwritten by the government pursuant to the War Risk Insurance Act.<sup>593</sup> The Act required payment of premiums to offset the cost of the insurance,

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<sup>589</sup> *Id.* at 396.

<sup>590</sup> *Faitoute Iron & Steel Co. v. Asbury Park*, 316 U.S. 502 (1942).

<sup>591</sup> *See id.* at 508-10.

<sup>592</sup> *See, e.g.,* Schwartz, Winstar: *Triumph of Congruence*, *supra* note 13, at 491; *see also* *United States v. Winstar Corp.*, 518 U.S. 839, 884-85, 895 (1996).

<sup>593</sup> *See Lynch v. United States*, 292 U.S. 571, 574-75 (1934).

which exceeded the total receipts from premiums.<sup>594</sup> Congress later repealed the benefits entirely, and the Court struck down the repeal. Under the proposed framework, this insurance is an example of the government contracting in its private capacity. Benefits incident to employment or military service are generally contracts because they are offered as part of the government's efforts to find the market price for labor. The factors clearly distinguish this form of quid pro quo benefit from broader government benefits distributed as part of a social program or policy, such as Social Security. The sort of payments one normally refers to as government benefits do not involve a market risk that the government is either bidding too high or too low to fulfill the other need driving the government's entry into the market. Instead, Social Security involves a direct form of regulation of wage earners through their employers. The Social Security Administration has the authority to require payroll deductions from workers' paychecks. Wage earners cannot opt out. The program serves a broad social goal of providing living incomes for the elderly and disabled. As such, benefits are modified frequently by Congress, without creating any contract liability for the government.

The *Lynch* Court distinguishes between contracts, like the life insurance, and "gratuities" such as "[p]ensions, compensation allowances and privileges"<sup>595</sup> by noting that "[t]he benefits conferred by gratuities may be redistributed or withdrawn at any time in the discretion of Congress."<sup>596</sup> The Court goes on to apply a sort of reverse unmistakability presumption: "[N]o power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress."<sup>597</sup> This presumption is logical because one would not read into a private contract the power of one party to alter the terms later. The Court goes on, however, with reasoning that should have given Souter pause:

Contracts between individuals or corporations are impaired within the meaning of the Constitution whenever the right to enforce them by legal process is taken away or materially lessened. A different rule prevails in respect to contracts of sovereigns. . . . "The contracts between a Nation and an individual are only binding on the conscience of the sovereign and

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<sup>594</sup> See *id.* at 576-77 & n.2.

<sup>595</sup> *Id.* at 577.

<sup>596</sup> *Id.*

<sup>597</sup> *Id.* at 578.

have no pretensions to compulsive force. They confer no right of action independent of the sovereign will.”<sup>598</sup>

The Court explained that this means the government is allowed to waive its sovereign immunity and later reinstate it at will. “For immunity from suit is an attribute of sovereignty which may not be bartered away.”<sup>599</sup> The Court finally makes clear that had Congress merely withdrawn the veterans’ access to a judicial remedy for denial of their insurance proceeds, the legislation would have passed scrutiny.<sup>600</sup> Somehow the incidents of private contract present in the insurance policies indicated that Congress intended to create private “rights” protected by the Constitution.

This tortured reasoning puts tremendous emphasis on the government’s sovereign immunity.<sup>601</sup> When one analyzes *Lynch*’s full reasoning, the decision hardly seems a strong example of congruence, as Schwartz and the majority opinions in *Winstar* suggest.<sup>602</sup> Instead its language, much like that from *Cooke*, should be read as only describing one of the two government’s roles: “When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.”<sup>603</sup> Since the government offered the insurance in its private capacity, private contract rules should apply. The government would lose under the sovereign acts doctrine as well because the subsequent breaching legislation was narrow and targeted at repealing the contract obligations. In sum, *Lynch* provides far more support for the proposed framework than for the any of the majority opinions in *Winstar*.

Similar support for the proposed framework appears in the three *Gold Clause Cases*, which all denied the liability claims against the government when Congress removed the country from the gold standard and banned private ownership of gold. The agreements in *Norman* were contracts between two private parties. In *Nortz*, the agreements were gold certificates

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<sup>598</sup> *Id.* at 580-81 (quoting THE FEDERALIST NO. 81 (Alexander Hamilton)) (other citations omitted).

<sup>599</sup> *Id.* at 582.

<sup>600</sup> *See id.*

<sup>601</sup> It also puts pressure on the distinction between rights and remedies and encourages Congress to pursue an indirect method of renegeing on the government’s promises.

<sup>602</sup> See Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 490 n.35 and 491; *see also* United States v. *Winstar Corp.*, 518 U.S. 839, 884-85, 895 (1996).

<sup>603</sup> *Lynch*, 292 U.S. at 579 (citing *Cooke*, *inter alia*).



issued by the Treasury attesting to the availability of gold for the beneficiary. The Court had a relatively easy time denying liability in these two cases by relying on Congress's authority to regulate currency. The government had not entered into bargains with the plaintiffs in *Norman*; the certificates in *Nortz* functioned like money. In the third case, *Perry*, however, the agreements were government bonds which included clauses requiring payment in gold-backed currency. Under the proposed framework, government bonds are treated as private contracts. Therefore, the government would be allowed to raise only the sovereign acts doctrine as a defense. Since the legislation has a public and general effect, the defense would succeed and the government would escape liability. The Court's reasoning is easily reconciled to this framework. First, it found that the government had breached its contracts with the bondholders. But then the Court found it impossible to calculate damages.<sup>604</sup> A modern summary of the Court's reasoning might conclude that the Court viewed wealth, as measured by money, as a relative concept. Since everyone suffered the same reduction in wealth, no one suffered any (justiciable) harm. As mentioned above, this reasoning is perfectly consistent with the sovereign acts doctrine. *Perry* fits perfectly within the proposed framework.<sup>605</sup>

One could also test the proposed distinction between the government's two roles by looking at federal deposit insurance, or even federal crop insurance or the federal insurance of employee pension funds. In each case, the specific insurance contract should be seen as a government contract entered into by the government in its proprietary capacity. It is true that the government requires these forms of insurance as preconditions for other regulatory advantages, such as the authority to accept deposits or to get certain government-backed agriculture loans. But persons who do not have the insurance are free to choose whether to accept it, along with the privileges and conditions set by the government.<sup>606</sup> Moreover, there is no need to conclude, as Souter apparently does in *Winstar*,<sup>607</sup> that the mere presence of a contractual relationship converts all the related regulatory agreements into contracts. Souter omits, for example, that the insurance

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<sup>604</sup> See *Perry v. United States*, 294 U.S. 300, 354-58 (1935).

<sup>605</sup> It is also true that the separate opinions in *Norman* and *Perry* strongly suggest that the Court distinguished between private contracts and government contracts.

<sup>606</sup> This choice supports the due process theory of heavily regulated industries.

<sup>607</sup> See *United States v. Winstar Corp.*, 518 U.S. 839, 894 (1996) (reasoning that deposit insurance has both sovereign and proprietary aspects).

does not cover the thrifts, but instead covers its depositors. Souter is probably correct when he predicts that the government's two roles are likely to appear intertwined more often in the future,<sup>608</sup> but from this he concludes that it is appropriate to require damages for changes in regulatory policies. The sounder conclusion is that the need to reliably differentiate between the roles the government assumes in reaching agreements will only grow.

#### *D. The Four Defenses within the Proposed Framework*

The unmistakability doctrine is unquestionably such a powerful defense that it should be limited to a clearly defined and narrow set of circumstances.<sup>609</sup> Although many cases have recognized its merit, none have explained how to determine whether it should apply. After reading cases such as *Charles River Bridge*, one could easily conclude that the unmistakability doctrine amounts to a public policy exception to the enforceability of government contracts when those contracts strike terribly imbalanced bargains. In accordance with the expression that one does not get rich working for the government, it is advisable to cap the riches one can extract from the public fisc by contracting with the government. *Charles River Bridge* might reasonably stand for such a public policy exception, with the threshold being that only one or two generations of taxpayers need to suffer for the sake of upholding the government's contracting reputation.<sup>610</sup> Such a threshold might be high enough by itself

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<sup>608</sup> See *id.* at 894 ("such fusion [of government's two roles] will be so common in the modern regulatory state").

<sup>609</sup> If private parties to regulatory agreements could somehow have better information about the unmistakability doctrine, there would be far less need to limit it, however. Private parties would need only to bargain for what Souter refers to as a "second promise" by the government not to change its regulatory policy. See *id.* at 887. Earlier in his reasoning, Souter as much as admits that the parties could bargain around whatever rule the Court imposed: "To be sure, each side could have eliminated any serious contest about the correctness of their interpretive positions by using clearer language." *Id.* at 869.

<sup>610</sup> Cf. *Faitoute Iron & Steel Co. v. Asbury Park*, 316 U.S. 502, 515 (1942) (noting that legislation struck down in a prior decision "was found 'to have taken from the mortgage the quality of an *acceptable investment for a rational investor*'") (emphasis added); *County of Stanislaus v. San Joaquin & King's River Canal & Irrigation Co.*, 192 U.S. 201, 214 (1904) (upholding new lower rates despite water company's charter, and reasoning that "[o]ther circumstances might exist which would show the *original* rates much too large for fair or reasonable compensation

to limit the reach of the unmistakability doctrine enough to protect the government's contracting reputation.<sup>611</sup> Chief Justice Rehnquist seems to view the unmistakability doctrine along these lines, at least in part:

The wisdom of this principle arises, not from any ancient privileges of the sovereign, but from the necessity of protecting the federal fisc—and the taxpayers who foot the bills—from possible improvidence on the part of the countless Government officials who must be authorized to enter into contracts for the Government.<sup>612</sup>

This simple understanding of the unmistakability doctrine focuses on the fallibility of the officials who make the original agreement. This focus is probably more accurate than the concerns in *Fletcher* that “sudden and strong passions”<sup>613</sup> might tempt subsequent legislatures to repudiate government contracts. Because the government has developed, since the time of *Fletcher*, such a strong reputation as a contracting partner, the benefit of protecting that reputation seems to provide sufficient restraints on subsequent legislatures. Indeed, the government is probably the ultimate long-term player and so probably has a much stronger incentive to protect its reputation than other corporate players in the market. This is true even though the government's reputation as a contracting partner is better understood as a series of reputations attached to both the government as a whole, represented by the Treasury's ability to pay, and to each of the government's agencies. Viewing the unmistakability doctrine as balancing the need to let the government out of bad agreements with the need protect

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at the *present time*”) (emphasis added).

<sup>611</sup> Indeed, if the regulatory agreements in *Charles River Bridge* and the unmistakability cases are contracts, then these decisions have somehow managed not to ruin the government's contracting reputation yet.

<sup>612</sup> *Winstar*, 518 U.S. at 937 (Rehnquist, C.J., dissenting). Cf. Schwartz, *Winstar: Triumph of Congruence*, *supra* note 13, at 551-52. Schwartz interprets this passage as ultimately reflecting Rehnquist's concern that contracting officials might violate the Anti-Deficiency Act by agreeing to indemnify the private parties for changes in the applicable regulations. It is better to read Rehnquist's Anti-Deficiency concern as a criticism of Souter's scheme of liability under the Tucker Act than as a concern that contracting officials would violate the Anti-Deficiency Act by misunderstanding their authority. Rehnquist treats the risk-shifting promise in *Winstar* not as part of the intent of the parties, but as a promise implied in law and imposed essentially by the plurality. See *Winstar*, 518 U.S. at 930 (Rehnquist, C.J., dissenting).

<sup>613</sup> *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 137-38 (1810).

the government's reputation would justify conceptualizing the doctrine as a public policy exception to contract enforceability.

But such a reading of the unmistakability doctrine does little to clarify when the doctrine should apply, which is the key issue. The proposed framework cabins the unmistakability doctrine to the appropriate situations. The first factor, from *Home Telephone & Telegraph* and *AMTRAK*, will suffice where the sovereign itself has entered into the agreement at issue through passage of legislation. The proposed distinction between the sovereign and proprietary roles of the government takes advantage of the fact that governmental power is generally exercised, and regulatory agreements generally reached, through agencies with limited subject matter authority. The proposal synthesizes the various strands of thought from the relevant case law, yet condenses these ideas into sufficiently few factors to produce predictable results. It should produce more predictable results than either the five-element test proposed by Professor Griffith or the sliding scale proposed by Professor Schwartz. Moreover, the sovereign/proprietary distinction already serves as a major barrier to tort claims against the government. It is wise to use similar analysis for these areas of law so as not to create definitional pressure between claims that could be characterized as either contract or tort.

Moreover, the advent of the modern administrative state should minimize this difficulty. Owing to the development of general corporation laws, the government exerts very little sovereign regulatory authority through terms in corporate charters. As a general rule, chartering authorities have come to impose only the obligation to follow the laws, which the sovereign can change independently from the charter. Plaintiffs will seldom claim the charters themselves are contracts. Therefore, this difficulty is not likely to appear in the typical case, but only in the unusual cases, like *Winstar*, where the sovereign chooses to impose more specific regulatory provisions in the charter. Second, sovereigns generally act through administrative agencies, both to issue corporate charters and to regulate them. This element of administrative delegation provides the basis for enforcing, against the agency, the promises it has made to the corporation in the charter. This alternate basis for enforcement relieves the pressure to treat the charter as a contract in order to hold the agency to its promises. A determination that the government acted in both capacities in issuing the charter need not create much analytical confusion. Focusing the analysis of the factors on the disputed provision should resolve any lingering confusion.

In the municipal utility cases, the disputed provisions involved the government's power to regulate rates, a sovereign function. Similarly in

*Winstar*, the provision at issue was regulation of capital levels. Conversely, the provisions at issue in *Lynch* were payment of insurance benefits, not the government's ability to regulate insurance contracts. Of course, Congress could have exercised its Commerce Clause authority to regulate the insurance contracts at issue in *Lynch*, but it did not. Moreover, the agency that made the contract did not have regulatory authority over life insurance. Once again, the government's widespread reliance on agencies clarifies the analysis considerably because agencies do not have plenary sovereign power, only limited authority. These limitations are of tremendous assistance in determining whether the agency is acting in a sovereign capacity.

The proposed framework provides a logical theory for enforcing regulatory agreements against the agencies that make them, and thereby avoids treating these agreements as illusory agreements, even when the agency does not have the authority to bind Congress. This would increase the effectiveness of agencies to pursue experimental policies, while still leaving Congress the ability to overrule these experiments without having to purchase the right to do so from the regulated entities. At the same time, it gives the regulated entities assurance that they can enforce the regulatory agreements against the agency should the agency decide on its own that it would prefer to rescind the agreements. This aspect of the proposed framework is unique; the proposals of Griffith and Schwartz do not touch on this facet of delegation at all, nor do they propose an alternative basis for the enforcement of regulatory agreements. Rather, their proposals work entirely within a contractual perspective and look for rational exceptions to contractual rules. The more complete, logical approach is to retreat a step and recognize the applicability of the due process perspective and then address the threshold question of which perspective is more applicable in a given situation. The proposed framework accomplishes this without overturning any major precedent, except *Winstar*, and without requiring any amendments to the Administrative Procedures Act. More generally, recognition of the delegation issue is essential to squaring a general theory of government contracts with the post-New Deal reality of the administrative state. In this light, *Winstar*'s hostility to the administrative state becomes all too clear.

The proposed framework would apply equally well to both state and federal regulatory agreements and contracts. From the perspective of the private party, it should not make significant difference whether the governmental party is state or federal in judging the agreement's validity and enforceability. Even *Winstar* acknowledges that the sovereignty-protecting function of the unmistakability doctrine traces back to inherent

attributes of sovereignty applicable to both state and federal governments.<sup>614</sup> Certainly, the trend in the Court's Contracts Clause jurisprudence has been to relax its scrutiny of state legislation infringing on contract rights to the point where the scrutiny is close to the deferential due process review accorded federal legislation that similarly infringes contract rights. Whatever one thinks of the trend, *Winstar* fits poorly into the surrounding jurisprudential landscape.

The proposed framework would apply the sovereign acts doctrine to all government agreements, i.e., both government contracts and regulatory agreements. *Horowitz*, *Jones*, and *Deming* clearly contemplate government contracts that fall on the proprietary side of the framework's initial distinction. Analytically, it is more difficult to decide what to do on the sovereign side. But the difficulties ought not pose much of a practical problem in light of historical examples. Every instance of a regulatory agreement scrutinized in these cases was breached by subsequent legislation that would have failed the public and general test of the sovereign acts doctrine. For example, the new lower rates in the unmistakability cases, the new competing charter in *Charles River Bridge*, the repeal of the opt out provisions in *POSSE*, and the termination of supervisory goodwill in *Winstar*.

It is certainly conceivable that a comparatively narrow regulatory agreement could be rolled back by a subsequent, broader piece of legislation; in such a case, the same need to protect the government's ability to enact new laws exists. A relevant hypothetical example would have the banking agency promising to recognize goodwill (and not to change its regulation), relying on delegated authority to bind the government as a whole, but being forced to breach the agreement by much broader legislation from Congress (for example, by legislation banning recognition of goodwill in mergers of all types of corporations). The original promise was unmistakably clear, but because of its narrow scope relative to the subsequent breaching legislation, it does not make sense that it should effectively limit the government's ability to pass other broader legislation.

In any event, the unlikelihood of this issue arising under the proposed framework suggests that this particular rule is not essential to the framework's success. After all, even in this hypothetical, the difference in scope of the original promise and the subsequent breaching legislation is

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<sup>614</sup> What *Winstar* does not do is explain how its holding affects the state unmistakability decisions.

not so great that the latter obviously qualifies as public and general.<sup>615</sup> What is essential to the framework's success is that the government could raise the sovereign acts doctrine when it reached its original agreement in its private capacity and that, in such cases, the government could not raise the other special contract defenses.

Moreover, the congressional intent element implicit within the sovereign acts doctrine should also help to minimize abuses by Congress. It also seems that the alternative—blocking the government from raising the sovereign acts defense for regulatory agreements—invites the creation of another public policy exception. While this sort of reasoning can often be justified in particular cases, it is submitted that a reasoned basis is a preferable theory, as it allows greater predictability in general as well as clearer bases with which to compare the exceptional cases.

In addition to the rationality and predictability of results stemming from adoption of the proposed framework, it would greatly reduce the definitional pressure that *Winstar* creates between government contract law and takings law. Under the proposed framework, damage awards are available only under the Tucker Act, when the government has contracted in its private capacity. Regulatory agreements are enforceable via injunctions under the APA.

For contracts reached in the government's private capacity, it could raise only the sovereign acts doctrine, in addition to traditional contract defenses. Under the sovereign acts doctrine, the government would need to show that the subsequent, breaching legislation had a public and general effect. As discussed in Part I, this standard closely resembles the singling-out standard from takings law. Proof of being singled out is not, of course always sufficient to make out a takings claim, and so there would still be numerous claimants who might do better by bringing a Tucker Act claim than a takings claim. The proposed framework shines on this point however, when compared to the *Winstar* regime. Under *Winstar*, the only apparent threshold issue for coming under its generous damages rule is evidence of some form of agreement, license, or approval from the government to form the plaintiff's so-called contract with the government. The inevitable result will be unguided arguments and unpredictable decisions about the threshold definitional issue of whether the plaintiff's approval or license constitutes a sufficient contract to take advantage of *Winstar*. This can only harm both the government contracts and taking jurisprudences and clog the appellate courts.

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<sup>615</sup> It might fail Schwartz's complete generality test, for example.

## CONCLUSION

Viewed strictly from within the assumptions and perspectives applied by the majority opinions, *Winstar* makes some logical sense. Apparently driven by the desire to avoid the appearance of overturning any precedents, however, the plurality opinion demonstrates a disappointing intellectual disingenuousness. For it is the selection of the contractual perspective that ultimately controls the outcome, but this selection is never analyzed. Even within the contractual perspective, however, the majority opinions miss two key aspects of the parties' intentions. First, the rationality of the supervisory goodwill cannot be separated from the NWMAs. To say that the thrift owners would have been crazy to agree to the approvals without the supervisory goodwill should force a recognition that the thrift agencies would have been just as crazy to approve the mergers without the NWMAs. Since the courts have generally struck down the NWMAs—reasoning that they amount to regulatory agreements and therefore not contracts—the Court in *Winstar* creates confusion by failing to explain whether its ruling overturns this contrary finding relating to the very same category of agreements.

Second, *Winstar* fails to implement the likeliest intention of the parties: that the agreements would bind the banking agencies but said nothing about Congress or the Treasury. As Rehnquist points out in dissent, the plurality's Holmesian presumption of a damages promise seems to violate the rule in government contracting against promises implied in law.

But the greater analytical failing is *Winstar*'s failure to address the true threshold issue of which perspective to apply to regulatory agreements. Because governmental agreements are equally susceptible to two very different analyses, the distinction between the government's sovereign and private roles is essential to clear analysis of the law governing these agreements. Currently, court decisions must be analyzed by comparing facts and outcomes because the opinions do not address either the difference of perspective or the parallel tension between the need to protect the power of the current majority to govern and the reasonable reliance interests of individuals.

Prior to *Winstar*, the law of regulatory agreements consisted of a series of unstable, overlapping, and sometimes contradictory exceptions to contract law. Although *Winstar* did not create these problems, it made matters worse by using the case law's failure to clarify the implicit threshold issue—when do these defenses apply?—and insert a wholly new rule that virtually overrules the special defenses entirely. The resulting backdoor importation of a regulatory takings agenda cannot be a coincidence.



In addition to the damage done to the law of regulatory agreements, *Winstar* destabilizes the surrounding takings, economic due process, and the Contracts Clause jurisprudences by creating an unhealthy definitional pressure between these claims. Instead of facing the jurisprudence that has built up over two hundred years regarding takings, and which has consistently rejected a conservative regulatory takings regime, the plurality in *Winstar* outflanks this jurisprudence and installs its functional equivalent. The message to would-be takings plaintiffs could not be clearer. All the while the Court can disingenuously claim not to have overruled its precedents in these other areas. After all, by avoiding any discussion of whether the supervisory goodwill provisions constituted contracts, the Court left open the issue of whether any regulatory agreement would suffice as a contract, including whether virtually any sort of license, grant, approval, or charter could also qualify.

Perhaps the theoretical weaknesses in the opinion will ultimately weaken *Winstar* as a precedent. There is the initial difficulty in discovering the basis for the holding. If it is simply based on the Tucker Act, then it seems to contradict the Court's holding in *Hercules* that the government cannot be held to contracts implied in law (precisely the sort of presumption advocated by *Winstar*). Moreover, if the basis is the Tucker Act, then the plurality's discussion of the Due Process Clause as the basis of the special defenses is incorrect. If it is statutory, presumably Congress could and should overrule it by limiting the Tucker Act to government contracts based on the distinction between the government's sovereign and private roles, just as it has under the Federal Tort Claims Act. If *Winstar* is somehow constitutionally required, then does it apply equally to state regulatory agreements? If not, then the states, which must comply with the Contracts Clause, would seem to enjoy a much stronger defense than the federal government, which has traditionally been limited only by the more lenient standards of the Due Process Clause. On any of these groundings, *Winstar* makes little sense doctrinally.<sup>616</sup>

In sum, *Winstar* handcuffs the ability of Congress to update the policies tried by regulatory agencies. It is simply disingenuous to claim that payment of damages for changing policies does not restrict the sovereign

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<sup>616</sup> Cf. Levy, *supra* note 130, at 329. Professor Levy describes a process of "reinvigoration and retreat" in which conservative constitutional property theories advance but ultimately face pressure to retreat growing out of their weak theoretical underpinnings. *Id.* See also *id.* at 357-58 (arguing that regulatory takings is the latest advance of conservative thought on property, but it too will ultimately be forced to retreat).

power of government. When the Founding Fathers gathered to draft the Constitution, they debated initially about whether to form a democracy or a republic. The republic famously emerged, but with democratic ideals intact. Those seeking to protect vested property rights could not select a better system of government than a republic, designed as it is to protect individual rights. But this individual liberty has always been balanced by the democratic need to allow the majority room to govern. The tension between these two strands of political theory has long defined our constitutional history. *Winstar's* greatest sin can be summarized as throwing balance to the wind and validating only the individual values so well protected by a republican system. *Winstar* makes no serious effort to protect the other strand of American political theory: democracy. The price of this begins at \$30 billion and will go up from there when other regulatory policies are updated.

The proposed framework, by contrast, suffers none of these glaring faults. It clarifies the operation of each of the special contract defenses and their relationships to one another. The unmistakability doctrine must, of course, be limited to apply only when sovereign power is at issue. It makes no sense for typical government contracts. The express delegation doctrine should be updated in two ways. First, it should be made clearer when an agency is bound to its promises and, second, should allow Congress to change outdated or unwise regulatory policies. But again, the government should not be able to raise the defense when it acts as a private contractor. Both the unmistakability and express delegation doctrines should work to improve the accountability for binding agreements by more specifically locating the decisionmakers.

At the same time, the government should be allowed to raise the sovereign acts defense when the original agreement was made in the government's private capacity. The missing link in this logic has been distinguishing between the government's roles as sovereign and private contractor. The proposed framework provides just such a workable test, one that seems to have worked well under the Federal Tort Claims Act.

Finally, the proposed framework fits much more comfortably than *Winstar* with the adjacent areas of law. In the case of a typical government contract, a plaintiff would see very similar standards under the Takings Clause and under the sovereign acts doctrine: both would ask whether the plaintiff has been unfairly singled out or if the breaching action has a public and general effect. Plaintiffs suing based on reliance on a regulatory agreement would face the unmistakability doctrine as a defense or the Court's traditional reluctance to allow a regulatory takings theory.

The proposed framework thus minimizes the definitional pressure between similar types of claims. This rough harmony in legal standards encourages a more honest debate about the standards that ought to govern these types of claims, instead of the fractionalized and misleading debates within each area. Most importantly, the proposed framework reaches a much more effective balance between the right of current majorities to govern effectively and the rights of individuals to rely on government promises.