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# The Constitution, the Legislature, and Unfair Surprise: Toward a Reliance-Based Approach to the Contract Clause

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# NOTES

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### INTRODUCTION

During the first eighty years of the Republic, the Contract Clause[1] was the constitutional rule most frequently invoked to strike down state legislation.[2] Private parties successfully cited the clause's prohibition in challenges to impairments of land grants,[3] corporate charters,[4] and private debts.[5] After a period of somewhat reduced activity,[6] however, the Contract Clause fell into disuse between 1934 and 1977.[7] It enjoyed a brief renaissance in the late 1970s,[8] but more recent Contract Clause challenges to state legislation have met with limited, if any, success.[9]

Over the course of our constitutional history, the Supreme Court's focus in Contract Clause jurisprudence has shifted from a concern for

1. U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."). Private parties raising Contract Clause challenges may do so in an action for declaratory and injunctive relief. *E.g.*, Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978); Manigault v. Springs, 199 U.S. 473 (1905). Such challenges, however, also may arise in actions to quiet title, City of El Paso v. Simmons, 379 U.S. 497 (1965), in suits to enforce contractual rights, Energy Reserves Group Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983), and by way of defense in actions under a challenged statute. Home Bldg. & Loan Assn. v. Blaisdell, 290 U.S. 398 (1934).

2. *See* BENJAMIN F. WRIGHT, JR., THE CONTRACT CLAUSE OF THE CONSTITUTION 51-88 (1938).

3. Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810).

4. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

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

6. During this time, from just after the Civil War to the 1930s, substantive economic due process came into vogue, thereby decreasing the need for the Contract Clause. *See* Douglas W. Kmiec & John O. McGinnis, *The Contract Clause: A Return to the Original Understanding*, 14 HASTINGS CONST. L.Q. 525, 534 (1987).

7. *Id.*

8. *See, e.g.*, Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978) (striking down a law impairing pension agreements); United States Trust Co. v. New Jersey, 431 U.S. 1 (1977) (striking down legislation modifying the state's own obligations).

9. *See, e.g.*, General Motors Co. v. Romein, 112 S. Ct. 1105 (1992) (holding constitutional the application of modified workers' compensation laws to prior claims); Keystone Bituminous Coal Assn. v. DeBenedictis, 480 U.S. 470 (1987) (denying Contract Clause protection to surface subsidence damage agreements modified by statute); Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400 (1983) (upholding legislation applied to extant natural gas pricing schemes).

individual expectations to the protection of the public good.[10] The Court's early decisions concerning retroactive state statutes[11] highlight the clause's original purpose of ensuring that states not defeat private parties' reliance interests.[12] More recent decisions demonstrate the Court's departure from the reliance standard.[13] In addressing Contract Clause challenges today, the Court weighs the competing state and private interests.[14] In doing so, the Court asks whether the law at issue substantially impairs the individual's contractual rights, whether the law is intended to serve a significant and legitimate public purpose, and whether the means utilized by the government to effect that purpose are reasonable and necessary.[15] Further, the Court now takes a less deferential stand than it once did toward legislative determinations of reasonableness and necessity when the state is a party to the impaired contract.[16]

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10. *See infra* Part I.

11. "Retroactive" statutes are those laws that affect private rights created through contracts entered into before the enactment of the law. One commentator describes the interaction between new law and past and continuing transactions as "vested rights retroactivity." *See* W. David Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 CAL. L. REV. 216, 218 (1960) ("If the effect of a law is substantially to disturb patterns of conduct that represent substantial investments in labor or property or to remove valuable rights, rights of action or even liberties, then the law is [vested rights retroactive].") (footnotes omitted).

Slawson contrasts vested rights retroactivity with "method retroactivity." Method retroactivity concerns arise when "laws . . . make rights or duties depend on past events in the narrow sense of dependence on events that have occurred and terminated before the laws were enacted." *Id.* at 217. However, he later asserts that the distinction is illusory because in both cases the retrospective law affects ongoing rights and claims. *Id.* at 220.

Although this Note does not rely on the method versus vested rights dichotomy, the reader should be aware that this Note deals primarily with vested rights retroactivity problems.

12. *See, e.g.*, Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819) (striking down a law interfering with a chartering party's expectations); Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810) (invalidating a state statute defeating land grant recipients' expectations). For a full discussion of these two decisions, see *infra* notes 40-46 and accompanying text.

13. *See, e.g.*, Home Bldg. & Loan Assn. v. Blaisdell, 290 U.S. 398, 444-48 (1934) (introducing a multiple-factored "legitimate ends" test into the Court's determination).

14. That is, the judiciary determines the relative weight of public and private interests implicated. *See, e.g.*, Keystone Bituminous Coal Assn. v. DeBenedictis, 480 U.S. 470, 485-86, 505-06 (1987) (finding that the public interest in preserving a surface owner's property from subsidence damage outweighs a mining operator's contractual rights); Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 250-51 (1978) (holding that the severity of the contracting parties' impairment outweighs the government's interest in protecting prisoners). Although the Court does not explicitly dub its approach a balancing test, numerous commentators have so termed this process of identifying and comparing substantiality of impairment and significance of state interests. *See, e.g.*, Note, *Rediscovering the Contract Clause*, 97 HARV. L. REV. 1414, 1415-16 (1984) (discussing modern Contract Clause jurisprudence); Michael B. Rappaport, Note, *A Procedural Approach to the Contract Clause*, 93 YALE L.J. 918, 919-22 (1984) (discussing *Allied Steel* and United States Trust Co. v. New Jersey, 431 U.S. 1 (1977)); Richard G. Taranto, Note, *A Process-Oriented Approach to the Contract Clause*, 89 YALE L.J. 1623, 1641-42 (1980) (discussing *Allied Steel* as a balancing case).

15. *See* Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400, 411-13 (1983) (setting forth the elements of the Court's current test). For a full discussion of the Court's balancing factors, see JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW 394-407 (4th ed. 1991).

16. *See* United States Trust Co. v. New Jersey, 431 U.S. 1, 30 (1977).

From a methodological standpoint, the Court's approach has progressively limited the scope and meaning of the Contract Clause by reading into it various exceptions. From the landmark case of *Home Building & Loan Assn. v. Blaisdell*[17] through more recent cases,[18] Contract Clause decisions have moved incrementally toward what is essentially a test of governmental prerogatives. The current standard determines the clause's applicability according to the strength of the particular interests a piece of state legislation represents. Through this piecemeal approach, over time, the Court has moved away from its original concern for contractual expectations and speaks now primarily in terms of state powers and private impairments.[19] This process of defining Contract Clause doctrine through a balancing of interests has deprived the clause of the clarity it once possessed.

In two cases from the 1980s,[20] however, the Court resurrected a modified form of the reliance logic in one factor of its determination. This factor is known as the "heavily regulated industry" doctrine (HRID). Under this doctrine, when a party conducts business in a "heavily regulated" field, the retroactive effects that a new rule imposes on that business will survive Contract Clause scrutiny. The doctrine assumes that a private actor, in entering a heavily regulated field, knows the government exercises a great deal of control over that industry. The doctrine further assumes that the actor also realizes that the legal backdrop against which she conducts business is subject to change. Therefore, the private party cannot reasonably expect her operations and relations, as subject to the changing regulatory scheme, to remain unaffected by a modification in the law.[21]

This Note argues that the Court should return to a reliance-based approach to Contract Clause challenges, fashioned loosely along the same lines as the HRID. Although it does not advocate that the Court revivify the rules created by the early decisions, the Note proposes that the Court look to the private parties' expectations and, more specifically, to the reasonableness of those expectations in deciding the clause's applicability to a particular case. Part I provides a brief history of the Contract Clause and its development. This Part follows the clause from the Constitutional Convention through the

17. 290 U.S. 398 (1934).

18. *See infra* section I.B.

19. *See infra* section I.B.

20. Exxon v. Eagerton, 462 U.S. 176 (1983); Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400 (1983). For a full discussion of these two decisions, see *infra* notes 119-25 and accompanying text.

21. "The justification given for this sweeping principle is that the parties are on notice that if the legislature has competence in a given field, it may well exercise its powers, and therefore there is no unfair surprise when these powers are exercised retroactively." Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 700 (1960).

1980s to illustrate the Court's departure over time from the original meaning of the clause. Part II discusses the heavily regulated industry doctrine and demonstrates how it represents a return to a focus on party expectations. Having set forth the theoretical underpinnings of the heavily regulated industry doctrine, this Note in Part III extends the doctrine's logic to create a modified reliance model for applying the Contract Clause. The Part argues that the reasonableness of a party's expectations as to the validity or enforceability of her contracts varies according to the amount of previous legislation in an area, as well as the "publicness" of the party's transactions. This Note concludes that this modified reliance approach has several advantages over the Court's current test, including greater continuity with early Court precedent and better guidance both for private parties and legislatures.

## I. THE COURT'S SHIFT IN PERSPECTIVE

The Supreme Court's emphasis in its Contract Clause jurisprudence has drifted significantly since the Constitution's ratification. The clause's early history reflects an overarching theme emphasizing private reliance marks.[22] Beginning with *Home Building & Loan Assn. v. Blaisdell*[23] in 1934, however, the Court has forsaken its original focus on party expectations in favor of a more fluid, but less certain and less predictable, balancing of state power against private interests. Ultimately, this shift deprives the Contract Clause of a single guiding principle and gives both legislatures and courts more freedom than the Framers intended.[24]

This Part illustrates the differences in the Court's treatment of the

22. This period lasted roughly from the time of the Constitutional Convention to the New Deal era. *But see* Kmiec & McGinnis, *supra* note 6, at 534. Kmiec and McGinnis identify four periods in Contract Clause jurisprudence: 1810-1879, during which the Court vigorously applied the clause to strike down state legislation; 1879-1934, during which the clause fell into disuse while economic substantive due process enjoyed broad application; 1934-1977, when the Court substantially narrowed the purview of the clause, thereby rendering it "a virtual nullity"; and 1977 through the present, during which time the Court has increased scrutiny of state legislation, without a single coherent approach. *See id.* Although this Note does not dispute Kmiec and McGinnis' four-period model, the Note departs from this model because the Court's methodology, though not its application of the clause to particular cases, remains constant between periods one and two and between periods three and four. In light of this Note's focus on methodology, the distinction between these periods is insignificant.

23. 290 U.S. 398 (1934).

24. *See, e.g.*, Kmiec & McGinnis, *supra* note 6, at 526. The current absence of a single guiding principle has drawn criticism in academic circles. Kmiec and McGinnis, for instance, note:

> It is ironic that the Supreme Court has chosen to apply the Contract Clause by balancing social interests in the manner of the legislature when the intent of the Clause was to forbid legislatures from retrospectively interfering with contracts. It is equally ironic that the Supreme Court has interpreted a constitutional provision that was designed to provide certainty to contracting parties in a manner that maximizes the unpredictability of its application.

*Id.* at 559.

Contract Clause from the time of the Constitution's ratification through the present. It further indicates some of the weaknesses of the Court's current test. Section I.A discusses the clause's early history and its original aim of protecting individuals' reasonable reliance interests. Section I.B examines the Supreme Court's more recent treatment of Contract Clause challenges and illustrates the Court's change in perspective over time. This section argues that the doctrinal shift from protection of party expectations leaves individuals without standards by which to judge the wisdom of entering into particular transactions. Such an effect is particularly perverse in light of the Contract Clause's purpose of providing stability in private contracts. This departure also permits a lack of discipline on the part of both courts and legislatures in determining the wisdom and constitutionality of a given piece of legislation.

### A. *Early History: Focus on Party Expectations*

An examination of the preratification history of the Contract Clause demonstrates that the Framers' purpose in including the clause was to protect contracting parties from the unfair surprise[25] wrought by state legislatures.[26] Although the Contract Clause was not the subject of heavy debate in the Constitutional Convention,[27] the records of the Framers and the contemporaneous public discussion reveal an intent to protect contracting parties' expectations by prohibiting legislative interference with those expectations.[28] The clause derives from a portion of the Ordinance of the Northwest Territory providing that no law "shall in any manner whatever interfere with, or affect private contracts or engagements, bona fide, and without fraud previously formed."[29] The purpose of the quoted enactment was the "just preservation of rights and property."[30]

Unfortunately, unlike the Ordinance, the Contract Clause as ratified includes no statement of intent. Further, the debate in the Federal Convention centered more on the wisdom of the rule the clause em-

25. This Note uses "unfair surprise" to indicate the defeat of a reasonable expectation. It does not intend the term to be a qualitative judgment.

26. *See* Bernard Schwartz, *Old Wine in Old Bottles? The Renaissance of the Contract Clause*, 1979 SUP. CT. REV. 95, 96-97 (discussing the historical and theoretical bases of the clause).

27. "If a study of the social and political context of the clause reveals little about the intentions of the framers, not much more is to be gleaned from the historical accounts of the debates at the drafting and ratifying conventions." Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 706 (1984).

28. *See* THE FEDERALIST NO. 44 (James Madison); James Madison, Journal (Aug. 28, 1787), *in* THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 439 (Max Farrand ed., 1911).

29. An Ordinance for the Government of the Territory of the United States north-west of the river Ohio, ch. 8, 1 Stat. 51, 52 (1789).

30. 1 Stat. 52 (1789).

bodies than on its purpose.[31] Nonetheless, the ratification debates demonstrate a clear intent to preserve "rights and property" from retroactive state legislation.[32]

James Madison provided a detailed discussion of the clause's groundings in the *Federalist Papers,* in which he indicated that the clause was intended to create security in private expectations. In *Federalist No. 44,* Madison wrote:

> Very properly therefore have the Convention added this constitutional bulwark in favor of personal security and private rights; and I am much deceived if they have not in so doing as faithfully consulted the genuine sentiments, as the undoubted interests of their constituents. The sober people of America are weary of the fluctuating policy which has directed the public councils. They have seen with regret and with indignation, that sudden changes and legislative inferences in cases affecting personal rights, become jobs in the hands of enterprizing and influential speculators; and snares to the more industrious and less informed part of the community. They have seen, too, that legislative interference, is but the first link of a long chain of repetitions; every subsequent interference being naturally produced by the effects of the preceding. They very rightly infer, therefore, that some thorough reform is wanting which will banish speculations on public measures, inspire a general prudence and industry, and give a regular course to the business of society.[33]

Although some have argued that the "fluctuating policy," "sudden changes," and "legislative interferences" to which Madison referred consist only of debtor relief laws,[34] the clause's broad language does not suggest such a limited reading.[35] Moreover, Madison's own reference to the Contract Clause as a "constitutional bulwark in favor of personal security and private rights" plainly addresses all types of unfair retroactive legislation, not merely a narrow segment of such laws.[36]

Early in its history, the Supreme Court adopted a similar view of the Contract Clause and unfair surprise. The Court's early Contract Clause decisions hinged on what this Note terms the "traditional reli-

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31. *See* WRIGHT, *supra* note 2, at 1-12. As Wright indicates, there was little discussion of the clause during either the Convention or the ratification process. The issues raised typically concerned whether contractual impairments fell within the purview of the Ex Post Facto Clause, *id.* at 9-10, whether "such a provision would interfere with the passage of necessary legislation relating to the bringing of actions," *id.* at 8, and whether the prohibition would prevent states from reacting to "*great public calamities* and *distress.*" *Id.* at 13.

32. *See* Madison, *supra* note 28, at 440.

33. THE FEDERALIST NO. 44, at 301-02 (James Madison) (Jacob E. Cooke ed., 1961); *see also* THE FEDERALIST *supra,* No. 62 (James Madison), at 418-22 (voicing similar concerns regarding the length of Senate terms).

34. *See* WRIGHT, *supra* note 2, at 13-15 (discussing concern for stability of private debts at time of ratification). *But see* Kmiec & McGinnis, *supra* note 6, at 533-34 (refuting the debtor relief theory of clause's purpose).

35. *See* Epstein, *supra* note 27, at 706-07 (discussing the intentional generality of the clause's language).

36. THE FEDERALIST, *supra* note 33, at 301.

ance model."[37] In these cases, the Court looked to the private expectations the impaired contract reflected to determine whether a Contract Clause violation had occurred. For instance, Chief Justice Marshall asserted that impairment of contracts by state legislatures had the effect of "break[ing] in upon the ordinary intercourse of society, and destroy[ing] all confidence between man and man."[38] He also opined that such interference "sap[ped] the morals of the people, and destroy[ed] the sanctity of private faith."[39]

The opinion of the Court in *Fletcher v. Peck*[40] provides a good example of the Court's use of the traditional reliance model. In this case, the Court struck down a Georgia statute defeating the expectations of purchasers in the Yazoo land sale. The Georgia act sought to nullify land grants by the state legislature that were facilitated by "open and wholesale bribery."[41] In holding that the law violated the Contract Clause, Chief Justice Marshall reasoned that the Framers designed the clause to check "the violent acts which grow out of the feelings of the moment; and that the people of the United States, in adopting that instrument, have manifested a determination to shield themselves and their property from the effects of those sudden and strong passions to which men are exposed."[42] The Court thus posited that the Contract Clause's purpose was to protect parties from unexpected deprivations of vested rights.

Still early in the nation's history, the Court in *Trustees of Dartmouth College v. Woodward*[43] found a Contract Clause violation by looking to the express intent of the contracting parties.[44] This deference to express intent also reflects the Framers' concern for protecting party expectations.[45] Chief Justice Marshall, writing for the majority, found that the state of New Hampshire's attempt to modify the terms of Dartmouth College's charter ran afoul of the Contract Clause's prohibition. The Court specifically noted as its guiding principle "the necessity and policy of giving permanence and security to contracts, [and] of withdrawing them from the influence of legislative

37. *E.g.*, Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819); Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810). The traditional reliance model looks to the parties' actual expectations to determine whether the Contract Clause forbids state interference. *See* Taranto, *supra* note 14, at 1627-29.

38. Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 354-55 (1827) (Marshall, C.J., dissenting).

39. 25 U.S. at 354-55.

40. 10 U.S. (6 Cranch) 87 (1810).

41. WRIGHT, *supra* note 2, at 21.

42. 10 U.S. (6 Cranch) at 138.

43. 17 U.S. (4 Wheat.) 518 (1819).

44. The Court determined the parties' express intent by examining the "will of the founder, expressed in the charter." Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 652 (1819). The Court emphasized the founders' intent to demonstrate the presence of an injury due to the legislation.

45. 17 U.S. (4 Wheat.) at 648-50.

bodies, whose fluctuating policy, and repeated interferences, produced the most perplexing and injurious embarrassments."[46]

Even the early cases that created limited exceptions to the clause's application adopted a view that the clause aimed to protect reasonable party expectations. In the eminent domain and police powers cases,[47] the Court addressed the tension between the state's interest in providing for the common good and in satisfying private expectations. The conflict between these two interests arises when the state seeks by way of retroactive legislation to forbid conduct or destroy rights in the name of the public welfare. In this context, a court must either thwart the state in its efforts to serve its citizenry by preserving the vested contractual rights or defeat the private rights by permitting the state to execute its policies as the state sees fit. In this line of cases, the Court reasoned that individual expectations must yield when in conflict with a state's powers.[48] It therefore carved out limited exceptions to the Contract Clause's broad sweep.[49] Yet the Court did not reach this result by an ad hoc balancing of the rights and powers at issue in each circumstance. Rather, the Court created a rule of contractual construction that presumed that party expectations were tempered by knowledge of certain of the state's substantive powers, such as its police and eminent domain powers.

The first exception to the Contract Clause permitted a state to exercise its eminent domain power. In *West River Bridge Co. v. Dix,*[50] the West River Bridge Company challenged a Vermont statute allowing municipalities to take, in the interest of the public good, private property to establish public roads.[51] In its discussion of the Contract Clause question, the Court set forth the competing constitutional rules at issue. While acknowledging the importance of the prohibition against the impairment of contracts, the Court stated:

> [I]n every political sovereign community there inheres necessarily the right and the duty of guarding its own existence, and of protecting and promoting the interests and welfare of the community at large. . . . This power, denominated the *eminent domain* of the State, is, as its name imports, *paramount to all private rights vested under the government,* and these last are, by necessary implication, held in subordination to this power, and must yield in every instance to its proper exercise.[52]

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46. 17 U.S. (4 Wheat.) at 648.

47. *See, e.g.,* Stone v. Mississippi, 101 U.S. 814 (1880) (addressing police powers); West River Bridge Co. v. Dix, 47 U.S. (6 How.) 507 (1848) (addressing eminent domain power).

48. *See, e.g.,* Manigault v. Springs, 199 U.S. 473, 480-81 (1905) (cataloguing cases supporting the view that the state's interest in protecting its citizens is paramount to private contractual rights).

49. *See infra* notes 50-64 and accompanying text.

50. 47 U.S. (6 How.) 507 (1848).

51. 47 U.S. (6 How.) at 530-31.

52. 47 U.S. (6 How.) at 531-32 (second emphasis added).

The Court noted that, despite the Constitution's position as the supreme law of the land, a court should not construe the Contract Clause to deprive the states of their powers of "self-government and self-preservation."[53] Because the eminent domain power fell within those powers, the Court upheld the state statute.

Of particular importance in the Court's decision were the legal bases upon which property rights rest. Because rights in land within a state's boundaries exist only by virtue of state grant and state protection, every private sale or possession of title in land involves an element of state consent. As such, the Court noted:

> [I]nto all contracts, whether made between States and individuals or between individuals only, there enter conditions which arise not out of the literal terms of the contract itself; they are superinduced by the preexisting and higher authority of the laws of nature, of nations, or of the community to which the parties belong; *they are always presumed,* and must be presumed, *to be known and recognized by all,* are binding upon all, and need never, therefore, be carried into express stipulation, for this could add nothing to their force. Every contract is made in subordination to them, and must yield to their control, as conditions inherent and paramount, wherever a necessity for their execution shall occur.[54]

The Court thus read into every property right the implied condition that whatever interest may have existed in that property was always subject to the state's necessary power to resume possession of that property.[55] The exception became part of the contract itself.

This implied term methodology also appeared in the police powers cases. In *Stone v. Mississippi,*[56] the Supreme Court addressed a Contract Clause challenge to legislation revoking a twenty-five-year charter for the operation of a lottery. The post-Civil War provisional government in Mississippi had granted the charter, but, one year later, the state adopted a new constitution forbidding the authorization of a lottery.[57] The central issue in *Stone* was whether "the legislature of a State can, by the charter of a lottery company, defeat the will of the people, authoritatively expressed, in relation to the further continuance of such business in their midst."[58] In its analysis, while acknowledging that the limits of the police power are poorly defined, the Court stated that the power at least "extends to all matters affecting the pub-

53. 47 U.S. (6 How.) at 532.

54. 47 U.S. (6 How.) at 532 (emphasis added).

55. " 'This right of resumption may be exercised, not only where the safety, but also where the interest, or even the expediency, of the State is concerned.' " 47 U.S. (6 How.) at 535 (quoting Beekman v. Saratoga & Schenectady R.R., 3 Paige Ch. (N.Y.) 45, 73 (1831)). The breadth of this power thus distinguishes it from the police power discussed *infra* notes 55-63 and accompanying text.

56. 101 U.S. 814 (1879).

57. 101 U.S. at 819.

58. 101 U.S. at 819.

lic health or the public morals."[59] Because the Court considered lotteries and gambling to be included in such matters, it found that they were subject to the operation of the police powers.[60] Therefore, the Court held the legislation to be valid.

More important for current purposes is the Court's discussion of the inalienable character of the state's police power and how this inalienability creates an implied term in all contracts. The majority stated that a legislature may not "bargain away" the ability to provide for public health, safety, and morals,[61] nor can it "divest itself of the power to provide for them."[62] By reading into every contract a police powers escape clause, the Court exempted statutes affecting the public health, safety, and morals from the Contract Clause's prohibition. Although it refused to protect actual party expectations in such circumstances, the Court maintained a focus on reliance. By demanding that parties consider the possibility that the state would exercise its police powers, the Court did not wholly abandon its traditional reliance model, but rather limited the model by defining an area in which reliance on legal stability is inherently unreasonable.[63] In other words, the Court required that the party expectations be reasonable in order to receive protection. The Court deemed that reasonable expectations account for the state's police power.[64]

### B. Blaisdell *and the Court's Shift in Perspective*

In an attempt to expand the limited exemptions embodied in the eminent domain and police powers decisions, the Supreme Court in the 1934 case *Home Building & Loan Assn. v. Blaisdell*[65] shifted its emphasis from party reliance to an examination of state prerogatives. Methodologically speaking, the Court abandoned the implied term

59. 101 U.S. at 818.

60. 101 U.S. at 818-19.

61. " 'Irrevocable grants of property and franchises may be made if they do not impair the supreme authority to make laws for the right government of the State; but no legislature can curtail the power of its successors to make such laws as they may deem proper in matters of police.' " 101 U.S. at 817-18 (quoting Metropolitan Bd. of Excise v. Barrie, 34 N.Y. 657 (1866)).

62. 101 U.S. at 819.

63. Moreover, given the conditions under which the charter was granted, it is not entirely clear that the lottery company did not expect that the charter might be modified. At that time, most, if not all, of the states, heavily disfavored lotteries and the U.S. Congress had passed a law forbidding the use of the mails for lottery purposes. 101 U.S. at 819. Indeed, up until the time of the provisional government, Mississippi had prohibited lotteries. 101 U.S. at 819. The company therefore might have foreseen that once the state returned to popular control the state would resume its original policy.

64. The same logic applies in contracts between private parties, not merely in situations involving state-individual relations. *See* Manigault v. Springs, 199 U.S. 473 (1905) (holding that a state's grant of a franchise impairing an obligation between the grantee and another private party does not run afoul of the Contract Clause when the state takes such action in the exercise of its police powers).

65. 290 U.S. 398 (1934).

logic of the earlier cases for an ad hoc balancing test permitting the state to exercise its powers irrespective of reasonable expectations, constructive or actual.[66]

By way of a four-factor test, *Blaisdell*[67] extended the earlier exemptions from the mere power to provide for health, safety, and morals to a broader power to react to other emergencies. *Blaisdell* involved a Minnesota mortgage moratorium law passed to relieve certain effects of the extant economic depression.[68] In upholding the Minnesota law, the Court rested its reasoning on a long examination of the historical exercise of the police power and the prerogatives of the legislature.[69] The Court cited the rule that the Contract Clause will not prevent a legislature from reacting to natural and physical disasters,[70] or to scarcity affecting the common weal.[71] The *Blaisdell* Court found that, read together, the decisions permitting such reaction represented a "growing recognition of public needs and the relation of individual right to public security."[72] In light of these "public needs," the legislature must have "the capacity . . . to protect [the public's] fundamental interests," even in the face of vested individual interests.[73] The Court therefore extended what had been a narrow exception for the police and eminent domain powers, or "reserved" powers, to cover legislation "addressed to a *legitimate end.*"[74]

For present purposes, *Blaisdell* is significant for the Court's test to determine the "legitimacy" of the state end put forth to support a challenged statute. Whereas the *Stone* Court discussed the police power as an apparently unqualified power,[75] the "legitimate ends" analysis under *Blaisdell* required: (1) the existence of an emergency; (2) that the "relief afforded . . . be of a character appropriate to that emergency"; (3) that the impairment be reasonable; and (4) that the legislation be effective only during the exigency.[76] The "appropriate

66. Again, the "implied term" methodology represents an approach whereby the Court read into every contract an implied term: the contracting parties realized and voluntarily subjected themselves to the possibility that the legislature might modify their contract by statute. For a discussion of the *Blaisdell* test, see *infra* notes 67-77 and accompanying text.

67. 290 U.S. 398 (1934).

68. Specifically, the law allowed for postponement of foreclosure and sale of properties for which the holder was in default, and for extension of the holder's redemption period. These provisions were effective during the period the legislature had determined an emergency to exist. 290 U.S. at 415-18.

69. 290 U.S. at 439-42.

70. American Land Co. v. Zeiss, 219 U.S. 47 (1911) (upholding California emergency title registry legislation enacted in the wake of a catastrophic San Francisco earthquake).

71. Block v. Hirsh, 256 U.S. 135 (1921) (holding a District of Columbia rent control statute valid in light of a housing shortage due to World War I).

72. *Blaisdell,* 290 U.S. at 443-44.

73. 290 U.S. at 443-44.

74. 290 U.S. at 445 (emphasis added).

75. *See supra* notes 56-64 (discussing *Stone v. Mississippi* and the police powers doctrine).

76. 290 U.S. at 444-47.

character" and "reasonable impairment" requirements permit a court to make discretionary judgments based on factors that are inherently relative.[77] Moreover, these factors render legitimate a state act regardless of whether a private party should have factored the possibility of such action into its decision to contract. Although the Court could have retained the implied term methodology by creating an "emergency condition" exception similar to the police powers exception, the Court instead opted for a more sweeping and open-ended standard. The *Blaisdell* opinion thus departs from the focus on reliance embodied in the constitutional history and the Court's prior jurisprudence.

Later applications of the legitimate ends test broadened the exception as defined in *Blaisdell* and thus narrowed the purview of the Contract Clause. The Court thereby afforded legislatures even greater leeway in crafting laws that impaired contracts. For instance, the Court held that emergency conditions need not exist in order for the state to impair contracts in the name of mere "legitimate ends."[78] Further, the Court later noted that, with respect to necessity and reasonableness determinations, courts usually will defer to legislative judgments.[79] In doing so, the Court effectively abandoned *Blaisdell*'s demand that an impairment be "reasonable."

The Court's holding in *Blaisdell* set the stage for later decisions in which the Court engaged in wholesale balancing without regard to party reliance or unfair surprise. *Blaisdell* and its progeny essentially ignored the Contract Clause's original goal and thereby created an atmosphere in which market actors are uncertain as to how a court might treat their contracts. Rather, this line of cases leaves contracting parties to the whim of a balancing court's weighing of the factors that the particular court deems relevant.[80]

Drawing upon *Blaisdell* and subsequent cases defining and broadening the legitimate ends doctrine, the Court has formulated the test it currently applies. This test requires judges to engage in a multiple-factor balancing, in which they consider whether the state legislation is "*reasonable and necessary* to serve an *important public purpose,*"[81] as well as whether the impairment to the contract is "severe."[82] The modern Contract Clause jurisprudence vividly demonstrates the Court's abandonment of its original single-principled approach and its adoption of a less consistent, less certain standard. The Court now

77. *See* Rappaport, *supra* note 14, at 919 n.7 (examining the language of the Court's current test).

78. Veix v. Sixth Ward Bldg. & Loan, 310 U.S. 32, 39-40 (1940) (permitting states retroactively to apply modified building and loan laws even in the absence of an emergency).

79. United States Trust Co. v. New Jersey, 431 U.S. 1, 22-23 (1977).

80. *See* Rappaport, *supra* note 14, at 919 n.7 (discussing problems associated with the judicial discretion entailed in the current balancing test).

81. *United States Trust Co.*, 431 U.S. at 25 (emphasis added).

82. *E.g.*, Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 246 (1978).

looks primarily to the relative strength of the interests served and impaired by the legislation.

The Court's analysis in *United States Trust Co. v. New Jersey*[83] illustrates a continued adherence to *Blaisdell's* basic blueprint. This adherence is particularly striking in light of the fact that *United States Trust* was the first of two cases that comprised the late-1970s revival of the Contract Clause. In *United States Trust,* New Jersey had repealed a 1962 statute under which both New York and New Jersey agreed to limit the number of "mass transit deficit operations" the Port Authority could undertake.[84] Those challenging the action argued that the repeal sharply devalued the bonds in secondary markets and, more importantly, modified a statutory contract between the state and the bondholders.[85] Although the Court struck down the New Jersey act,[86] it demonstrated a willingness to uphold legislation not only when the state acts under a recognized power, but also when the "challenged state legislation [is] sufficiently important to warrant the legislation's frustration of contract-based expectations."[87] Even while recognizing the Contract Clause's purpose of protecting such expectations, *United States Trust* allows a court to abrogate that purpose through its balancing test.

A subsequent case made more clear the distance between the Court's original approach and its current test. In *Allied Structural Steel Co. v. Spannaus,*[88] the second decision in the Contract Clause's renaissance, the Court struck down a Minnesota pension benefits law on Contract Clause grounds.[89] The majority in *Allied Steel* looked to

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83. 431 U.S. 1 (1977).

84. 431 U.S. at 9-10. "Mass transit deficit operations" under the statute included, with enumerated exceptions, any rail transportation system or project. 431 U.S. at 10.

85. 431 U.S. at 17, 19.

86. The Court rested its ruling on the notion that the State had not employed a less drastic means to achieve its goals. *United States Trust Co.*, 431 U.S. at 29-31. Figuring prominently in the Court's holding was the fact that New Jersey sought to modify its own contractual obligation through the repeal. *See* 431 U.S. at 26, 31. There is some doubt, however, as to the validity of the Court's distinction between public and private contracts. *See, e.g.,* Kmiec & McGinnis, *supra* note 6, at 546 n.101, 547 (criticizing the distinction on the grounds that it enjoys no support from constitutional history or prior jurisprudence). For a possible justification of the Court's rationale in so holding, see *infra* note 174 and accompanying text (discussing government contracts).

87. Note, *supra* note 14, at 1415-16 & n.10; *see also* 431 U.S. at 18-21, 28-32 (discussing the relative importance of private and state interests).

88. 438 U.S. 234 (1978).

89. The statute required certain employers ceasing business operations in the state to purchase deferred annuities to cover the pensions of all employees who had worked for the employer for 10 or more years. *Allied Steel,* 438 U.S. at 238. The statute subjected the employer to this "pension funding charge" if the existing pension funds were insufficient to provide for all employees described above. This law was inconsistent with the petitioner's pension agreement with its labor force. The agreement created a tripartite priority system whereby the employer would use the funds first to pay those already retired, then those eligible for retirement, and, finally, those who did not yet have pension rights. The petitioner's contractual obligations, unlike those the law imposed, extended only as far as the amount in the pension fund. 438 U.S. at 237-38.

three factors in its balancing test: substantial impairment, existence of an "important general social problem," and existence of an emergency.[90] Although "the high value the Framers placed on the protection of private contracts"[91] proved influential in the Court's holding, that factor alone did not provide a sufficient standard to determine the validity of the act at issue. Rather, the Court returned to the balancing analysis in which it had engaged since *Blaisdell.* The Court first found the state had "substantially impaired" the petitioner's contract by modifying what the Court dubbed a "basic term" of that contract.[92] Further, the Court found no apparent "important general social problem" that the statute might purport to remedy.[93] Because the law applied only to private employers with one hundred or more workers terminating operations in the state, it would only affect a very narrow class. The Court thus distinguished the statute from the one at issue in *Blaisdell.*[94] Of particular import for the Court were the facts that the challenged legislation was not temporary in nature, and no economic emergency justified its enactment.[95] Consequently, no overriding state interest saved the statute from constitutional attack under the Contract Clause.

Even after this brief resurrection of the clause came to an end, the Court continued to cling to its practice of balancing interests in Contract Clause challenges. A recent manifestation of this phenomenon is *Keystone Bituminous Coal Assn. v. DeBenedictis.*[96] *Keystone Coal* involved an unsuccessful challenge to a Pennsylvania statute by an association of coal mining operators.[97] The operators asserted that the statute impaired agreements under which claims arising from damages to surface property were waived. Therefore, according to the petitioners, the law violated the Contract Clause. The Court, however, ruled that the statute did not create an impermissible contractual modifica-

90. 438 U.S. at 244-50. In light of the Court's abandonment of the "emergency" requirement in Veix v. Sixth Ward Bldg. & Loan Assn., 310 U.S. 32 (1940), it is unclear why the Court invoked it here. The obvious tone of *Allied Steel* reflects the majority's wish to resurrect the clause as a basis for vigorous constitutional review. Perhaps the Court felt that in order to do so it would have to narrow the circumstances in which a state could win in a balancing. *See* Note, *supra* note 14, at 1417 & n.18 (discussing the Court's method in *Allied Steel* as "strict scrutiny").

91. *Allied Steel,* 438 U.S. at 245.

92. 438 U.S. at 244-46. The language of reasonable expectation and reliance is particularly prevalent in this portion of the opinion. The Court specifically stated that in light of the employer's compliance with applicable tax laws, and the absence of any other legislative requirements regarding pensions, "[t]he company . . . had no reason to anticipate that its employees' pension rights could become vested except in accordance with the terms of the plan." 438 U.S. at 245-46.

93. 438 U.S. at 247-49.

94. 438 U.S. at 248-49.

95. 438 U.S. at 249.

96. 480 U.S. 470 (1987).

97. The act in question required operators to leave in place coal supporting the land on which "protected" surface structures rested. 480 U.S. at 502.

tion.[98] Once again, the Court relied on a fluid balancing test in reaching its decision. Although it found that the state of Pennsylvania had substantially impaired the contractual rights of the petitioners,[99] the Court held that, in light of the significant public purpose that the statute served[100] and the high degree of deference accorded to the legislature's choice of means to effect a legitimate end,[101] the law satisfied the modern Contract Clause standard.

*Keystone Coal* and the other recent decisions have solidified the Court's balancing approach, yet problems with this approach are manifest. The Contract Clause decisions since *Blaisdell* suffer from common weaknesses: overly broad judicial discretion, a dearth of standards for private actors, and an undue tolerance of undisciplined legislatures. First, the Court's current balancing approach permits inconsistent determinations in largely similar contexts. A juxtaposition of the Court's holdings in *Blaisdell* and *Allied Steel* serves to illustrate this phenomenon. While the Court in *Blaisdell* found that the economic crisis present at that time gave rise to an "emergency" within the meaning of the *Blaisdell* test, the *Allied Steel* Court found no such emergency. Indeed, although no serious general economic malaise existed at the time of *Allied Steel,* there apparently was a crisis in pension plans sufficient to give rise to a national initiative, ERISA.[102] The Court's finding of an emergency in *Blaisdell* and not in *Allied Steel* thus raises doubts as to the validity of the Court's methodology; one could dispute whether the state's interest in protecting pensioners' benefits is any less compelling than its interest in protecting the homes of its citizenry.[103] The sort of arbitrary distinction between these two values, which a balancing test permits, further deprives the Court's current standard of any pretense of consistency and fairness. Even if this distinction rests on the notion that the law in *Allied Steel* affects fewer people than that in *Blaisdell,* the balancing test relegates the Contract Clause to a mere matter of line drawing without regard to the clause's purpose of protecting contracting parties from unfair sur-

98. 480 U.S. at 478-79.

99. Because the act "remove[d] the surface owners' contractual obligations to waive damages," the Court agreed "that the statute operate[d] as 'a substantial impairment of a contractual relationship.' " 480 U.S. at 504 (quoting Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978) (footnote omitted)).

100. 480 U.S. at 485-86.

101. This aspect of the *Keystone Coal* opinion is somewhat confusing. While acknowledging the need that the modification of obligations be of a character appropriate to the state's goals, 480 U.S. at 505-06, the Court stated that, outside of a government contract scenario, it would not "second guess [a state's] determinations [as to] the most appropriate ways of dealing with [a] problem." 480 U.S. at 506. The Court thus seems to indicate that it will at once scrutinize and defer to legislative decisionmaking. *See* Kmiec & McGinnis, *supra* note 6, at 552.

102. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. § 1001-1461 (1988)).

103. *See, e.g.,* Kmiec & McGinnis, *supra* note 6, at 549.

prise. As the comparison between the holdings in *Allied Steel* and *Blaisdell* demonstrates, the sort of interest one Justice or iteration of the Court might view as "substantial," "compelling," or "important" in one context may not be so strong in another set of circumstances. Further, the relative weights judges assign to the same factor may vary drastically.[104]

Secondly, if the Court is indeed concerned with contract as a basis for "order[ing] . . . personal and business affairs,"[105] a balancing test certainly does not further that concern. By creating unnecessary uncertainty through judicial discretion and by failing to provide objective factors against which to judge the reasonableness of one's reliance, the Court has created a setting in which individuals must make a blind gamble when entering certain sorts of contracts. A market actor can only hope that, when a state enacts a retroactive statute, the balancing judge's subjective views harmonize with the private party's prediction.

Finally, the Court's balancing analysis allows states to pass overly sweeping legislation without regard to potential adverse retroactive effects. The legislature, absent some constant view of the meaning of the Contract Clause's prohibition, will not be deterred from passing laws without first determining whether those laws survive Contract Clause scrutiny. Rather, the legislature will more likely be inclined to chance a favorable balance in the courts.

## II. The Heavily Regulated Industry Doctrine and Uncertainty

The Court's recent treatment of Contract Clause challenges departs from the balancing approach described above in the context of heavily regulated industries. A heavily regulated industry is one for which the state has created an extensive body of regulatory law.[106] Historical and pervasive regulation of certain fields has given rise to the heavily regulated industry doctrine, whereby a court imputes to the legislature an intent to control all aspects of an enterprise.[107] The doctrine thus creates a broad rule that changes in a regulatory scheme will presumptively defeat a claim of reliance in a Contract Clause challenge.

The HRID represents a partial return by the Court to an expectations-based approach in modern Contract Clause challenges. The basic reasoning of the doctrine is couched in reliance and unfair surprise

104. *Compare* United States Trust Co. v. New Jersey, 431 U.S. 1, 31 (1977) (majority characterizing the impairment as "drastic") *with United States Trust Co.*, 431 U.S. at 41 (Brennan, J., dissenting) (describing impairment as causing "the most minimal damage").

105. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 245 (1978).

106. *See* Exxon Corp. v. Eagerton, 462 U.S. 176, 194 & n.14 (1983).

107. *See* 462 U.S. at 194 & n.14.

terms.[108] That is, by forcing private parties to recognize that the state exercises relative hegemony over a field, the doctrine presumes that those parties cannot reasonably expect legislative change not to affect private transactions in that area. Underlying this rationale are certain implicit assumptions concerning the nature of legal rules and the prerogatives of the bodies promulgating those rules. The doctrine rests in part on the inherent fluidity of laws and regulations in areas of heavy regulation.[109] Because the rules are mutable, the more pervasive an area's legal scheme, the less certainty an actor in that area will have. One cannot avoid this mutability by making a contract in the area, thereby creating some measure of stability.[110] The doctrine imposes the burden of this uncertainty on the private actor. In other words, the doctrine assumes that the actor has tailored her risk calculus with uncertainty in mind, and that she realizes that any expectations of continuity in the area are not reasonable. The doctrine thus mimics the implied term logic of the eminent domain and police powers decisions.[111]

Section II.A reviews the recent decisions invoking the heavily regulated industry doctrine and shows how those decisions reflect a reliance-based approach to the Contract Clause. Further, the section discusses how the doctrine departs from the current balancing test, and how it permits the state to act for the public good while maintaining a focus on party expectations. Section II.B examines the view of reliance implicit in the doctrine. This view assumes that, when determining whether to rely on a contract, a private party should look not only to the isolated transaction, but also to external factors bearing on the wisdom of that reliance. The section shows that when circumstances surrounding the transaction, such as state control over the contract's subject matter, suggest that legal change is likely, an expectation of legal stability is unreasonable. This conception of reasonableness and reliance is significant in three ways. First, it demonstrates the Court's renewed concern for party expectations. Secondly, the HRID's reasonableness analysis allows the Court to avoid ad hoc judgments of the Contract Clause's applicability. Finally, as will be-

108. *See* Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 413-16 (1983) (discussing the history of natural gas regulation in Kansas and finding that "[p]rice regulation existed and was foreseeable as the type of law that would alter contract obligations").

109. For full discussion, see *infra* section II.C.

110. *See, e.g.*, Hudson Water Co. v. McCarter, 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to State restriction, cannot remove them from the power of the state by making a contract about them. The contract will carry with it the infirmity of the subject matter.") (citations omitted). Although Justice Holmes' opinion in *Hudson Water Co.* does not exemplify the modern heavily regulated industry doctrine, its reasoning mirrors that of the modern doctrine.

111. *See, e.g.*, Stone v. Mississippi, 101 U.S. 814 (1879); West River Bridge Co. v. Dix, 47 U.S. 507 (1848). For full discussion of these cases and the implied term doctrine, see *supra* section I.A.

come apparent in Part III, the reasonableness and reliance thesis provides the groundwork for this Note's field occupation model. Section II.C identifies certain of these variables and discusses what in the nature of legislatures lends an element of uncertainty to state action. Section II.C.1 analyzes the conception of the legislature upon which the HRID rests. This analysis will entail a discussion of time and uncertainty as well as structural factors creating uncertainty in the state of the law controlling a contract. The section demonstrates how, in light of this uncertainty, a party cannot *reasonably* believe that the laws affecting a transaction or contract will remain static. Finally, section II.C.2 examines "inalienability" doctrine, which reasons that certain powers inhere in legislatures, and explains how the heavily regulated industry doctrine's tolerance of legislative change reflects inalienability concerns. The legislature's inalienable powers further contribute to the uncertainty imposed on contracting parties through state regulation. Given the HRID's view of reasonable expectations and the uncertainty associated with legislatures and legislative action, Part II concludes that, under the HRID, a court would hold expectations unreasonable where the expectations fail to appreciate the possibility of legislative change in regulated areas or in areas subject to the inalienable powers.

### A. *The Heavily Regulated Industry Doctrine Opinions*

An early enunciation of the heavily regulated industry doctrine's methodology appeared in the decision of *Veix v. Sixth Ward Building & Loan Assn.*[112] In *Veix,* the Supreme Court upheld the application of amended building and loan laws to building and loan shares bought before the amendments. The challenged portion of the statute modified prior law defining shareholder withdrawal rights.[113] The Court observed at the outset of its analysis the pervasive nature of building and loan regulation.[114] It is notable that the Court invoked the Tenth Amendment police power to find that the regulatory scheme as a whole constituted a legitimate exercise of legislative authority.[115] As such, any change in that body of law would also fall within the realm of state power. The Court thus asserted that, when a private party purchases "into an enterprise already regulated in the particular to which [the party] objects, he purchase[s] subject to further legislation

112. 310 U.S. 32 (1940).

113. 310 U.S. at 35.

114. 310 U.S. at 37 ("It is also plain that the [challenged] act was one of a long series regulating the many integrated phases of the building and loan business such as formation, membership, powers, investments, reports, liquidations, foreign associations and examinations.").

115. "With institutions of such importance to its economy, the State retains police powers adequate to authorize the enactment of statutes regulating the withdrawal of shares. . . . [T]he obligation of the Association to respond to the application for withdrawal was subject to the paramount police power." 310 U.S. at 38 (footnote omitted).

upon the same topic."[116]

*Veix* functions as a natural extension of the *Stone* Court's implied term jurisprudence.[117] In *Stone,* the Court held that a party must at all times temper its expectations with knowledge of the state's power to provide for the public health, safety, and morals.[118] Similarly, when a party initially contracts subject to a statute furthering a legitimate state interest, that party recognizes the state interest and should not be surprised by subsequent laws in the same area. The Court essentially created an implied contractual term providing for such legal change.

More recently, the Court has upheld modifications in the law even when the prior law did not directly regulate the contract at issue. In *Energy Reserves Group v. Kansas Power & Light Co.,*[119] Energy Reserves Group unsuccessfully challenged a Kansas statute controlling natural gas prices following federal deregulation. The Court maintained a balancing test, yet factored into its consideration "whether the industry the complaining party has entered has been regulated in the past."[120] The Court found that the natural gas industry was a heavily regulated field despite Kansas's failure specifically to regulate natural gas prices at the time of contracting. Because of the "extensive and intrusive" nature of the state's supervision of several aspects of the enterprise,[121] the new law defeated no reasonable expectations.[122]

Similarly, the Court in *Exxon v. Eagerton*[123] addressed a Contract Clause challenge to changes in state oil and gas laws. The Court found that a prohibition on the power of producers and distributors to pass along to purchasers the costs of a severance tax in fact restricted contractual obligations.[124] Nevertheless, the Court held that, because

116. 310 U.S. at 38 (footnote omitted). The Court justified this pronouncement by analogy to reserved power statutes whereby states are able to modify corporate charters. 310 U.S. at 40. The apparent connection between these two phenomena is that in both contexts, the state seeks to assert — either explicitly or implicitly — essentially plenary control over a matter.

117. *See supra* notes 56-64 and accompanying text.

118. Stone v. Mississippi, 101 U.S. 814, 821 (1879).

119. 459 U.S. 400 (1983).

120. 459 U.S. at 411. The elements of the test include inquiry into (1) the degree of impairment of the contract; (2) the public purpose behind the legislation; and (3) the reasonableness of the regulation in light of the purpose. 459 U.S. at 411-13. The Court thus did not abandon its balancing test but rather supplemented it with the heavily regulated industry doctrine. 459 U.S. at 411. Because of this adherence to the balancing test, it is unclear exactly how prominently the doctrine figured in arriving at the Court's holding.

121. 459 U.S. at 413-14 & n.18.

122. 459 U.S. at 413-16. The Court noted that "[s]tate authority to regulate natural gas prices is well established." 459 U.S. at 413 (citing Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950)). *Energy Reserves Group* thus seems to follow the formula of *Veix,* that is, asserting the legitimacy of the underlying scheme, then finding heavy regulation defeating reliance.

123. 462 U.S. 176 (1983).

124. The party challenging the statute retained the right to pass on the cost of the severance tax by contract. *See* 462 U.S. at 189 n.10.

regulation of the oil and gas industry fell well within the realm of the legislative power, regulation of the burden of taxation also was within that realm.[125] The Court thus apparently engaged in a two-step process, whereby it examined whether the initial exercise of power in that field was valid, then gave deference to state action in that field. Regardless of whether the state had spoken with respect to the specific matter on which the party seeks to contract, the Court would not invalidate a legal rule contravening agreed-to terms if the law fell within a field already subject to legitimate state regulation. The Court thus imputed validity from a general class of acts to a specific act.

Questions still exist as to exactly how much legislative activity in an area gives rise to heavy regulation. For instance, as *Energy Reserves Group* and *Exxon* suggest, laws touching upon the subject matter of the statute in a state or even another jurisdiction might create heavy regulation. Whether this also means that tangential regulation might render an entire industry heavily regulated is not clear. The closest the Supreme Court has come to enunciating a standard is in a Fourth Amendment context.[126] In *Marshall v. Barlow's Inc.*, the Labor Department argued that the presence of occupational safety and health regulations rendered Barlow's a " 'pervasively regulated business' " and therefore not protected by the Warrant Clause for OSHA purposes.[127] The Court rejected this assertion, however, reasoning that the pervasive regulation exception to Fourth Amendment rights applies only to industries with "such a history of government oversight that no reasonable expectation of privacy . . . could exist."[128] Although *Barlow's* arose in a context wholly unrelated to the Contract Clause, the Court's discussion of pervasive regulation in that case might prove instructive in determining what constitutes a heavily regulated industry.

The HRID represents a return to a focus on reasonable expectations in Contract Clause challenges. Although it permits a statute to defeat *actual* party expectations, it does so only when the party was unreasonable in its reliance. The doctrine achieves this effect by defining as inherently unreasonable an expectation of legal stability in a heavily regulated field. The doctrine thus gives parties a constant standard against which to judge the wisdom of transacting in reliance on the state of the law.

### B. *Reliance and Reasonableness*

The heavily regulated industry doctrine is important not only because of its return to a focus on reliance, but also because of the view

125. 462 U.S. at 194 & n.14.

126. *See* Marshall v. Barlow's Inc., 436 U.S. 307 (1978).

127. 436 U.S at 313 (quoting United States v. Biswell, 406 U.S. 311 (1972)).

128. 436 U.S. at 313 (citing Katz v. United States, 389 U.S. 347 (1967)).

of reliance the doctrine manifests. The heavily regulated industry doctrine imposes on contracting parties' reliance claims a requirement of reasonableness. That is, the doctrine deems that market actors should acknowledge substantial government control of their enterprise and tailor their expectations in light of that control.

Although much of the HRID's view of reliance is unspoken, the concept of reasonableness of expectations enjoys extensive discussion in legal scholarship. Professor Stephen Munzer explains that a "reasonable expectation" requires both "rationality" and "legitimacy."[129] The rationality of an expectation depends on the ability of the contracting party adequately to judge the probability of an occurrence. "[A]n expectation is rational if the probability assigned to the predicted event corresponds suitably to the actual likelihood that it will occur, and if the person making the prediction has good grounds for assigning the probability he does."[130]

One commentator has suggested that courts should view party reliance purely along rationality lines. From this standpoint, a court would treat legal change as any other frustrating market change. Professor Louis Kaplow submits that "[p]erceptive investors will typically act on probability estimates of possible changes in the legal regime, just as they will take into account the probabilities of changes in relevant market conditions — such as anticipated future demand, behavior of competitors, weather patterns, and the ultimate feasibility of untested inventions."[131] Kaplow proposes that, in light of the similarity between market and legal risks, investors should bear the burdens of legal transitions in the same way they do the burdens of market transitions.[132] A private party must absorb whatever losses arise from a prediction that proves, in retrospect, to be irrational. Kaplow would therefore do away with transition policies such as the Contract Clause,

129. Stephen R. Munzer, *A Theory of Retroactive Legislation,* 61 TEXAS L. REV. 425, 429 (1982).

130. *Id.* at 430. The reader should note that this model does not require absolute certainty in its prediction. Rather, it demands only that the party have a reasoned basis for her position — one which considers the possibility of changes in the environment surrounding the transaction, including both legal and market transitions. Expectations are neither entirely rational nor entirely irrational. Greater or lesser fluctuation in a state of affairs lends lesser or greater rationality to a contracting party's reliance on the stability of the status quo. A contracting party can never tell with moral certainty that the law will remain static. *See id.* at 456-57 (differentiating between "could not" and "would not" concerning the possibility of government change). If correctness in prediction were the standard for rationality, however, the occurrence of a legal change would defeat any expectation that no change would occur. *See* Louis Kaplow, *An Economic Analysis of Legal Transitions,* 99 HARV. L. REV. 511, 525 n.38 (1986). The Contract Clause would then become a dead letter. The question thus becomes what factors a market actor *should* consider in deciding whether to rely on a state of affairs, regardless of whether that condition in fact changes.

131. Kaplow, *supra* note 130, at 525-26.

132. *Id.* at 533-36.

whereby the government must relieve the risks it imposes on private actors.

Although the heavily regulated industry doctrine does not adopt Kaplow's suggestion regarding the abolition of transitional relief, it does assume that parties engage in a modified form of the risk assessment entailed in Kaplow's model. The HRID calculus, however, hinges on an expectation's legitimacy, not its rationality.

Legitimacy requires that the expectation harmonize with the spirit of the laws inducing the expectation, and with the "fundamental principles embedded in the legal system itself."[133] By way of illustration, Munzer provides the example of a market actor who conforms her actions to the letter of the law, yet knows that her acts run counter to the goals of the statute on which she relies.[134] A requirement of legitimacy, Munzer reasons, would "permit a frustrating change . . . even if a surprise . . . because of the way the change is connected with the justificatory structure of the institution."[135] Moreover, legitimacy bears on an expectation's rationality in that it informs the party's ability accurately to predict the future status and treatment of her acts. A party's estimation of probabilities cannot ignore pertinent facts regarding the purpose of a given statute or the legal system while maintaining a pretension of rationality.

Under the heavily regulated industry doctrine, the reasonableness of a challenging party's expectation depends less on her judgment as to

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133. Munzer, *supra* note 129, at 432.

134. *Id.*

135. *Id.* at 433. The reader might consider the legitimacy requirement in a "curative" legislation context. Professor Hochman delineates two categories of curative statute: (1) "statutes which ratify prior official conduct"; and (2) statutes "designed retroactively to cure defects in an administrative system." Hochman, *supra* note 21, at 704.

After a review of decisions treating statutes of both types favorably, Hochman concludes that "[i]t is necessary that the legislature should be able to cure inadvertent defects in statutes or their administration by making what has been aptly called 'small repairs.'" *Id.* at 705 (footnotes omitted). More important for present purposes, Hochman observes that "the individual who claims that a vested right has arisen from the defect is seeking a windfall since, had the legislature's or the administrator's action had the effect it was intended to and could have had, no such right would have arisen." *Id.*

Munzer's legitimacy requirement and the judicial tolerance of legislative correction are two sides of the same coin. As an example of a rational but illegitimate expectation, Munzer offers a scenario in which a man marries less than two years after obtaining a divorce from another woman. Under the law of his jurisdiction at the time of remarriage, a person cannot marry within two years after a divorce. Later, this man marries a third woman without first divorcing the second. In the time between the second and third marriages, however, the legislature repeals the two-year requirement. The man may now *rationally* expect that the second marriage is invalid under the law at the time it was entered into, and that he is therefore neither liable for alimony nor a bigamist. Munzer asserts that because the expectation was not *legitimate* — that is, that it was the purpose of the law to validate marriages within two years of divorce, the expectation is unreasonable. Munzer, *supra* note 129, at 433.

Curative legislation jurisprudence deals with the same type of scenario Munzer hypothesizes. The major difference between "legitimacy" and "correction" is in perspective. Whereas Hochman focuses on the need to allow governments to effect their stated goals, Munzer requires the actor to account for that need, and thus deprives the actor of reliance on a flawed law.

the likelihood of legal change in the field than on her acknowledgement of systemic factors, such as the state's interest in the subject matter of the contract. In this regard, the HRID's standard of reasonableness is a standard of legitimacy. The Court's reasoning in *Exxon* and *Energy Reserves Group* assumes that a market actor's reliance on the state of the law is unreasonable, or, more specifically, illegitimate, because of the nature of heavy regulation. Granted, it is conceivable that legal change in the heavily regulated field might be slow or even nonexistent, thus lending *rationality* to a prediction of stability. However, the party's expectation is inherently *illegitimate,* because one should not expect existing legal rules to be permanent.

Moreover, legitimacy would appear to subsume rationality for Contract Clause purposes.[136] The heavily regulated industry doctrine suggests that, when a state manifests its interest in a field through a scheme of regulation, a market actor should at all times account for that interest, irrespective of the likelihood of actual legal change.

Legitimacy-focused reasonableness determinations, like the HRID, permit broad classifications of reasonableness rather than case-by-case judgments. Courts may carve out areas in which expectations of legal continuity are inherently illegitimate. For instance, under the HRID, the Court has held that systemic factors create a lack of stability in zones of heavy regulation. In light of this uncertainty, the doctrine holds that anyone conducting business in a heavily regulated field subjects herself to the perils and pitfalls associated with such uncertainty.

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136. *See, e.g.,* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977). The Court in *United States Trust* held that a modification of a state's own obligation under a bond issue violated the Contract Clause. Professor Munzer questions the validity of this holding on the grounds that the bondholders could not reasonably expect the state not to modify its obligation. Munzer, *supra* note 129, at 456-61.

Munzer first argues that the bondholders' reliance was irrational if they believed the covenant "*could not* be repealed." *Id.* at 456-57. "[T]he bondholders . . . should have considered that the contract clause had been heavily qualified and that for forty years the Supreme Court had struck down no statute on its sole authority." *Id.* at 457. The challenging parties thus gave insufficient weight to the possibility of repeal in their risk assessment.

As to the legitimacy of the bondholders' expectations, Munzer turns to the "fundamental principles embedded in the legal system" to argue that the expectation was illegitimate. The concept that a past legislature cannot limit by contract a future legislature's power to act in the public interest, and the fact that economic legislation is not subject to close scrutiny, both militate against the legitimacy of the parties' reliance. *Id.* at 457-58.

It would appear that in this respect, Munzer's two requirements overlap. For instance, how can a party "rationally" expect that a flawed law will not change? Would not the intent of the law and the legal system's basic principles figure in the ability to predict an event? Further, Munzer either engages in a little bootstrapping here, or he would have a party include in her calculus the courts' likely treatment of a challenge, as well as the probability of state action. The notion that the contracting party in *United States Trust* should have considered the fact that the Court over the course of 40 years had rendered the Contract Clause a virtual nullity is profoundly circular. Munzer seems to say that the Contract Clause is dead because the Contract Clause is dead. If, however, he suggests that individuals consider their chances of vindicating their rights in court, then market actors would have to account for matters far remote from their transactions. This would inject another variable into a party's risk calculus — the arbiter as affecting expectations.

This practice of effecting broadly applicable standards achieves two significant benefits. First, by avoiding individualized conclusions of rationality or irrationality, the practice serves judicial economy. Secondly, by explicitly defining zones of uncertainty, courts can provide market actors with hard and fast rules on which to base their decisions whether or not to contract.

### C. *Legislatures and Legislation*

Although the HRID presupposes the need to account for subsequent state legislation in an actor's reasonableness calculus, the Court has not explained why this requirement is important. The Court merely assumes that the state might decide to change the legal scheme. This section seeks to define the view of legislatures inherent in the heavily regulated industry doctrine's assumption that legislative action is an uncertain variable in a party's risk analysis. The section addresses institutional factors which create instability in the legal backdrop against which contracts are made and explains how these fundamental principles underlying the legal scheme affect and inform party reliance. Central to a party's reasonableness calculus is an understanding of discontinuities in legal institutions and the legislative product. Such an understanding clarifies the factors causing a party's belief in the stability of the legal scheme ultimately to be unreasonable.

This examination of the factors underlying discontinuities in the legislative product addresses two aspects of legislatures. Section II.C.1 analyzes how the nature of a fluid lawmaking body — that is, a body reconstituted at periodic intervals — leads to changes in priorities and preferences, which in turn create legal discontinuities. Section II.C.2 examines the inherent and reserved powers of state legislatures to show that their lack of stability ultimately affects a private actor's ability to rely reasonably on an underlying legal framework in entering into a contract.

#### 1. *Time and Uncertainty*

One of the principal factors contributing to changes in legislative preferences is remoteness in time. This factor is crucial to an understanding of why legal changes arise as well as why the HRID tolerates such changes. Much as individuals may be poor predictors of their future preferences, lawmakers are plagued by uncertainty as to what future conditions will require. In many contexts, legislative and otherwise, an inverse relationship exists between distance in time and the ability to foresee the wants and needs of one's future self. This phenomenon manifests itself in the tendency to discount future pains and pleasures, and to accord inordinate weight to present pains and

pleasures.[137] A juxtaposition of this predisposition in individual and legislative contexts bears out this assertion. When a party contracts to perform a service five years hence, that party makes two predictions. First, she predicts that external conditions — for example, the economy and the environment — will allow performance for which she will receive fair consideration. Second, she predicts that her preferences will remain substantially the same.[138] For the sake of efficiency,[139] the law assumes that the individual's second prediction is correct, although this assumption is not necessarily accurate.[140] Except under certain circumstances,[141] the law assumes the first prediction to be accurate.

In the context of a fluid legislature, these assumptions become less safe. Not only does the lawmaking body face the uncertainty inherent in making decisions that will not come to fruition until some time in the future, it also must predict the preferences both of its future self and of its constituency. A fluid legislature, by definition, will not be the same body from time *A* to time *B*, nor will the population the body represents remain constant from *A* to *B*. A lawmaker may be able to gauge with a high degree of certainty her principals' wishes. However, when she seeks to speak for a more hypothetical population, that assurance fades.[142] Shifts in the makeup of the constituency, as well as shifts in its condition, force the legislature to reevaluate its defined policies and goals. Should the institution fail to engage in such a practice, certain sectors of the population would not enjoy representation in all matters, nor would they enjoy equal status with those sectors whose preferences are reflected in a prior legislative pronouncement.[143] Therefore, by according full representation through the pro-

137. This tendency is what is known as a "bias toward the near." *See* DEREK PARFIT, REASONS AND PERSONS 159 (1984).

138. *See* Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 780 (1983) (designating the first type of prediction, if erroneous, as giving rise to "disappointment," and the second type as giving rise to "regret").

139. Some scholars have argued that respect for contract does not merely serve efficiency concerns, but that such a model also acknowledges and protects personal autonomy. *See, e.g.*, Stewart E. Sterk, *The Continuity of Legislatures: Of Contracts and the Contracts Clause*, 88 COLUM. L. REV. 647, 653 (1988).

140. *See id.* at 657.

141. *See, e.g., id.* at 655-57 (discussion of bankruptcy, impossibility, and commercial impracticability exceptions to the American rule of respect for contract).

142. *Id.* at 660 ("[E]specially if one assumes constituents and their representatives to be individualistically oriented, one might expect that a current legislature, representing current individuals, will not adequately account for the interests of future individuals not yet born, not yet of the age of majority, or not yet citizens of the state.").

143. Further, the failure to reevaluate the preferences of even a static constituency would not allow for individual discontinuity within that group. To "lock in" the wishes of the population as of a certain point in time is to deprive that population of the opportunity to avoid Kronman's "regret." *See supra* note 138.

cess of reevaluation, the lawmaking body adds greatly to the possibility of inconsistent legislative product.

Legislatures themselves are subject to frequent change. Indeed, one manifestation of shifts in the constituency and its preferences is the periodic reconstitution of the legislature. The membership of the institution might therefore differ greatly from one period to the next. Prospective decisions of a present legislature involve a prediction of what its future self as an institution would decide. Because of the differences in content over time, however, the institution cannot be considered continuous with itself in the same way an individual might.[144] A different legislature brings changes in institutional perception not merely from personal discontinuities among the representatives, but also from a different membership.

The HRID relies, in part, on the fact of legislative discontinuity. The doctrine's tolerance of legal change implicitly recognizes that lawmakers often change their minds in light of new circumstances and preferences. By removing heavily regulated industries from the Contract Clause's reach, the HRID ensures that no constitutional barrier prevents legislatures from acting on the basis of such changes.[145]

### 2. *The Powers of the Legislature*

In addition to the timing considerations section II.C.1 addresses, the HRID finds its theoretical bases in the legislature's necessary powers as well as in analogous constitutional doctrine. "Inalienability" doctrine, a theory developed first in theory and scholarship,[146] then in the courts,[147] stands for the proposition that a lawmaking body may not contract away, either explicitly in contract or implicitly by legislative act, a power inherent in that body or granted by the Constitution. The "inherent" and "reserved" powers of state legislatures, two areas of inalienability, comprise part of the fundamental principles of the legal system which bear on an expectation's reasonableness. The HRID presupposes the existence of these powers in its insistence that the state be able to reverse itself and to promulgate new policy. The doctrine thus renders illegitimate any expectation that the state would not exercise its powers.

Inalienability doctrine helps to explain why we should tolerate discontinuities in the legislative product and why a party must account

144. The fact that a representative may have to campaign for reelection at frequent intervals skews the legislator's perception. If the lawmaker's individual concern is for reelection, she will be more likely to seek to satisfy the short-term goals of her constituency and ignore long-term concerns. The convention of election thus contributes to the representative's, and thereby the institution's, bias toward the near. *See* Sterk, *supra* note 139, at 661.

145. For further discussion of the propriety of allowing a present legislature to define the interests of and to bind a future legislature, see *infra* section II.C.2.a.

146. *See infra* section II.C.2.a.

147. *See infra* section II.C.2.b.

for such legal change in its reasonableness calculus. The inherent powers accrue to the legislature simply by virtue of the legislature's status as a popularly elected organ. These powers account for many of the concerns voiced in section II.C.2 by forbidding one legislature from binding its future self. Similarly, the reserved powers under the Tenth Amendment permit legislative discontinuities out of concern for popular sovereignty.[148] Such "essential attribute[s] of sovereignty"[149] allow the state to act in the name of the public good when circumstances so require. To permit a party to deprive the legislature of its ability to exercise its prerogatives under these powers would thwart that institution in its efforts to effect important public goals.

*a. Inherent powers.* The legislature's inherent powers flow directly from the body's discontinuous nature. As Professor Paul Kahn notes, "[n]ot only do its interests change, as reflected in new majorities displacing earlier ones, but the constituents themselves change."[150] These changes necessitate a general prerogative "to respond to changing circumstances [and] to reorder priorities in light of these changes."[151] Inherent powers doctrine derives from a belief in the need that popular sovereign authority exist always in the present. "For the Legislator is he, not by whose authority the Lawes were first made, but by whose authority they now continue to be Lawes."[152] Scholars have therefore been skeptical of a framework of rules binding the sovereign in perpetuity. "It is thus, in the name of legislative supremacy, that the English invoke the Blackstonian axiom: 'Acts of Parliament derogatory from the power of subsequent parliaments bind not.' "[153]

The institution's power to abandon, amend, or otherwise modify existing legal rules reveals itself in the concomitant inability to control later iterations of the same body.[154] This limit on legislative power

148. *See* NOWAK & ROTUNDA, *supra* note 15, at 405 (describing Tenth Amendment powers as "the residual prerogatives of sovereignty which the states had not surrendered to the federal government") (footnote omitted).

149. Paul W. Kahn, *Gramm-Rudman and the Capacity of Congress To Control the Future,* 13 HASTINGS CONST. L.Q. 185, 221 (1986) (citing United States Trust Co. v. New Jersey, 431 U.S. 1, 23 (1977) (stating the rule that prior legislative acts cannot work as a bar to the exercise of reserved powers)).

150. Kahn, *supra* note 149, at 199.

151. *Id.*

152. THOMAS HOBBES, LEVIATHAN 315 (Crawford B. Macpherson ed., Penguin Books 1984) (London 1651).

153. Julian N. Eule, *Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity,* 1987 AM. B. FOUND. RES. J. 379, 393 (1987) (quoting 1 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND *90).

154. *Cf.* Kahn, *supra* note 149, at 222-23 & n.135 (citing cases consistent with the "concept [that] legislative authority . . . is linked essentially to that of popular sovereignty. A legislative measure that purports to bind future legislatures is, accordingly, an illogical or inappropriate attempt by the agent of the sovereign to bind the principal.").

The reader might note at this point that it is somewhat perverse that the legislative process

appears in "last-in-time" rules of statutory construction: when two pieces of legislation are in direct conflict, a court will usually apply the more recent rule, because that rule will be the more accurate statement of the popular will and current circumstances.[155]

Principles of utility and equality also favor the prohibition against "entrenching," that is, imposing the preferences of the prior legislature and constituency without the option of modification or repeal. First, the utilitarian would see that a present legislature has better access to information available at a lesser cost than does a past legislature.[156] A prohibition against entrenchment thus allows for policies tailored to present conditions, and cuts down on factfinding costs for the past legislature.[157] Further, allowing entrenchment invites tortured interpretations of law and wasted resources in attempts to circumvent the rule.[158] Entrenchment offends egalitarian concerns because it would prevent the newer constituency from enjoying equal status with its predecessors. By placing *its* interests above those of its successors, the past legislature deprives a future population of representation, thereby relegating that population to a lower position in the legal scheme. Sovereignty would therefore turn upon a rule of "first-in-time."[159]

Ultimately, the notion of inalienability undermines a market actor's ability to rely on a given state of the law. If a party attempts by assertion of reasonable reliance to maintain the status quo as of the time of contracting, inalienability doctrine deprives that status quo of any pretension of permanence. The mandate of the prior legislature controls only until a later iteration of that body contradicts it. Indeed, the inevitable concomitant of an entrenchment prohibition is a future

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requires such institutional freedom given the basis of the constitutional system. The Framers created a constitution which was to bind future generations. In doing so, the Constitutional Convention built in mechanisms which would prevent frequent modification of the document.

Kahn does not find rules defining special amendment or repeal procedures to be problematic in all circumstances. For instance, Kahn cites the Administrative Procedure Act's express repeal provision as an example of such a rule. *Id.* at 201-03 (citing 5 U.S.C. § 559 (1989)). Because "the APA rule does not purport to regulate the permissible content of legislative actions," Kahn does not find the provision offensive. Kahn, *supra* note 149, at 203. It is unclear whether the same can be said of the Constitution, and, indeed, whether the distinction between first-order (conduct directed) and second-order (rule directed) rules is valid.

155. *See id.* at 198 n.50. Alexander Hamilton characterized the concept of "last-in-time" in statutory interpretation as not merely a rule for the sake of consistency, but a rule of practical reason. *Id.* at 199-200 (quoting THE FEDERALIST, *supra* note 33, No. 78 (Alexander Hamilton), at 525-26).

156. *Cf.* JEREMY BENTHAM, HANDBOOK OF POLITICAL FALLACIES 55 (Harold A. Larrabee ed., 1952) (originally published as THE BOOK OF FALLACIES: FROM UNFINISHED PAPERS OF JEREMY BENTHAM, London, John & H.L. Hunt 1824).

157. *See* Eule, *supra* note 153, at 387.

158. *Id.*

159. *See* Kahn, *supra* note 149, at 198-99. Further, allowing a legislature to deprive itself of any of its powers gives rise to questions of self-reference reminiscent of Douglas Hofstadter's stereo-destroying record. DOUGLAS R. HOFSTADTER, GÖDEL, ESCHER, BACH: AN ETERNAL GOLDEN BRAID 75-78 (1979).

legislature's freedom to repeal. A party's failure to acknowledge this fact conflicts with the basic rules underlying the legal system and is therefore illegitimate and undeserving of Contract Clause protection.

*b. Reserved powers doctrine.* The reserved powers, such as the eminent domain and police powers, add to the states' ability to promulgate inconsistent legislative product. Apart from the general freedom to revise prior legislative acts, state legislatures may also invoke the powers reserved to the states under the Tenth Amendment when modifying the existing legal environment.[160] The reserved powers doctrine not only permits the institution to change its mind in matters on which it has previously spoken,[161] but also allows intervention into areas not explicitly covered by current law. Although the powers under this doctrine are not absolute, private parties enter into transactions subject to the legitimate exercise of the state's powers irrespective of the government's prior position.[162] These powers further limit a party's ability reasonably to rely on an underlying legal regime.

For example, the eminent domain power vests in the state a permanent power to defeat standing rights in property in order to serve the public good. In doing so, the power allows the state to claim land should the state's interests and preferences change with regard to property rights. Additionally, the power imposes upon private parties an element of uncertainty militating against an expectation of an absolute property interest.[163] The opinion in *West River Bridge Co. v. Dix*,[164] the decision in which the Court upheld a Vermont statute permitting state takings of realty for public purposes, illustrates a judicial concern that states have the power to resolve problems arising from imprecise prediction. By the grant of a right in property, the government predicts that such action is in the public interest, or at least not detrimental to the public good. Should it later be proven otherwise, a rule forbidding the state from retracting the right granted would deprive a present lawmaking body of a power existing in a prior one, the power to allow or not allow the property right to vest in a private actor. By imputing to the private party a recognition of the ability of the state later to divest the party of a property interest, the Court both assumes the possibility of legislative discontinuity and removes it from

160. *See* U.S. CONST. amend. X.

161. As noted in the discussion of reserved powers, *supra* section I.A, a state may only claim authority under the police powers when it acts to preserve the public health, safety, or morals.

162. *See* Stone v. Mississippi, 101 U.S. 814, 817-18 (1879) (stating the rule that action or inaction of prior legislatures does not bind a present legislature in the exercise of its police powers).

163. *See* Sterk, *supra* note 139, at 674-75 (discussing early eminent domain doctrine as a departure from the Marshall Court's supremacy of contract model).

164. 47 U.S. (6 How.) 507 (1848). For a full discussion of *West River Bridge Co.*, see *supra* notes 50-55 and accompanying text.

the purview of the Contract Clause.[165] Eminent domain thus effectively eliminates a challenging party's expectation of permanence of a property interest.[166]

Another of the reserved powers, the police power, imparts wide latitude to state legislatures in seeking to serve their citizens' interests.[167] As between the prohibition on contractual impairment and the state's charge to promote the common weal, the courts have long recognized that the former must yield to the latter.[168] That is, public interests trump private rights. A private party cannot escape the effects of a state's efforts to protect its citizenry under the police power, even by contracting concerning the subject matter of the new statute. In *Stone v. Mississippi,*[169] in which the Court upheld a law invalidating a lottery charter, the Court adopted the view that a party may not entrench an alienation of the police power. Despite the consequent uncertainty imposed on private actors by such a policy, the *Stone* Court's endorsement of this type of legislative discontinuity reflects the same concern for imprecise prediction expressed by the *West River Bridge Co.* Court.

The *Stone* decision, like the opinion in *West River Bridge Co.,* invokes a concept of "implied understanding."[170] Much as existing law

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> It, then, being clear that the power in question not being within the purview of the restriction imposed by the tenth section of the first article of the Constitution, it remains with the states to the full extent in which it inheres in every sovereign government. . . . This is, in truth, purely a question of power; and, conceding the power to reside in the State government, this concession would seem to close the door upon all further controversy in connection with it.

*West River Bridge Co.,* 47 U.S. (6 How.) at 533.

166. This is not to say, however, that a state may expropriate an individual's property without limitation. The eminent domain power is subject to the Takings Clause of the Fifth Amendment. The state must compensate a private party for the property of which it was deprived.

167. *See, e.g.,* Manigault v. Springs, 199 U.S. 473, 480-81 (1905) ("While this power is subject to limitations in certain cases, there is wide discretion on the part of the legislature in determining what is and what is not necessary — a discretion which courts ordinarily will not interfere with.").

168. *See, e.g.,* 199 U.S. at 480 ("This power, which in its various ramifications is known as the police power, is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals.").

169. 101 U.S. 814 (1879). For a full discussion of *Stone,* see *supra* notes 56-64 and accompanying text.

170. In light of the ever-present police power, "[a]ny one . . . who accepts a lottery charter does so with the implied understanding that the people, in their sovereign capacity, and through their properly constituted agencies, may resume it at any time when the public good shall require, whether it be paid for or not." 101 U.S. at 821; *cf. West River Bridge Co.,* 47 U.S. at 532-33 (discussing the inherent power of the state to divest a party of her real property).

Chief Justice Waite reconciled this portion of the holding with Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819), by adverting to the part of that opinion stating "that the framers of the Constitution did not intend to restrain States in the regulation of their civil institutions, adopted for internal government, and that the instrument they have given us is not to be so construed." *Stone,* 101 U.S. at 820 (citing *Dartmouth College,* 17 U.S. (4 Wheat.) at 629). Because depriving the state of Mississippi of its police power would function as such a

is incorporated into every contract,[171] the Court read the police powers into those same contracts. In this way, both legal rules and "metarules," like the police power and inalienability doctrine, become constructive terms of every contractual agreement. These metarules substantially limit a private party's ability legitimately to assert unfair surprise when the state acts under such rules.

The heavily regulated industry doctrine reflects reserved power and inalienability concerns in its view of the legislature's necessary powers. As to reserved powers doctrine, the heavily regulated industry doctrine adopts substantially the same methodology the *Stone* and *West River Bridge Co.* Courts employed. Apart from its similarity to the implied term logic in the reserved powers cases, the heavily regulated industry doctrine provides for the same policy concerns involved in the earlier cases. The doctrine carves out areas in which the state has particularly strong interests, then gives the legislature free rein in those fields. The doctrine also draws upon inherent powers doctrine in that the HRID seeks to prevent entrenchment of prior legislative wishes due to party reliance. Under the doctrine, the Court considers the most recent statement of the legislative will to be effective, regardless of the government's prior position. Thus, individuals cannot reasonably expect immunity from legislative changes.

## III. GOVERNMENTAL FIELD OCCUPATION

In light of the issues discussed in Part II, this Part suggests an approach to Contract Clause problems that accounts both for the reasonableness of party reliance and for the uncertainty inherent in any particular contractual context. This Note proposes that the reliance logic implicit in the heavily regulated industry doctrine applies beyond scenarios in which there is pervasive and historical state regulation. While the state creates uncertainty through heavy regulation, it also creates uncertainty by its need to exercise its substantive prerogatives such as the police power and eminent domain. The certainty with which a party contracts turns upon the legislature's interest in the subject matter of the contract. This Note terms the presence of such interests *field occupation.*

Under the field occupation model, a court will determine the presence of any unfair surprise solely by classifying a contract according to the nature and extent of state action in the field implicated by the contract, existing as of the time of contracting. In this respect, field occu-

restraint, Waite asserted that the act at issue would fall within the exception to the *Dartmouth College* rule.

171. This is not to say that a private party may claim existing law as a contractual term for the purposes of reliance. Rather, legal rules are only implied terms for the purposes of making the contract something more than an unenforceable promise. To hold to a more expansive view of incorporation would impermissibly "limit the ability of state legislatures to amend their regulatory legislation." General Motors Co. v. Romein, 112 S. Ct. 1105, 1111 (1992).

pation analysis is a test of legitimacy of the sort discussed in section II.B. A court will not look to each specific circumstance to determine an expectation's rationality. Rather, field occupation defines broad classes of legal instability in which an expectation of continuity will be illegitimate, or unreasonable. The model thus limits a court's analysis to finding whether a contract falls within an occupied area. The party's reliance will not be reasonable if the state has created sufficient uncertainty through the lawmaking process or even if such state action is likely to occur in the future. If a contract falls within such an area of uncertainty, no Contract Clause violation exists.

Field occupation analysis both accounts for the state's need to act in the public interest, and provides a constant standard against which parties might judge the reasonableness of their reliance. In addition, the field occupation model casts off the balancing method the Court currently uses. Regardless of the substantiality of the contractual impairment or the relative strengths of the public and private interests implicated, this test contemplates what a private party should expect in the way of government action.

Field occupation appears in three forms: "heavy regulation," "reserved powers" occupation, and "public purpose" occupation. Each of these three classifications of state action occupies a field in a different manner yet, in all three, a private party's expectations of stability are inherently unreasonable. Sections III.A, III.B, and III.C discuss these forms of field occupation respectively. Each section describes the different methods of occupation and the effects on party expectations. Because this Note has already discussed heavy regulation and reserved powers at length, this Part analyzes them only briefly. Public purpose occupation receives fuller treatment. Section III.C explains that when, at the time of contracting, a transaction is imbued with a public nature or impacts on the public interest in a way which might give rise to state action, the market actor should foresee the probability of such action and the consequent possibility of contractual impairment. Even absent prior government action, sufficient uncertainty exists under these circumstances to trump a reliance claim. Section III.C also suggests certain factors bearing the earmarks of public purpose field occupation that a court should consider in its determination. Section III.D argues that the field occupation model provides several advantages over the Court's post-1934 approach. These advantages include consistency with the clause's original purpose, clearer standards for private conduct, and incentives for greater discipline in legislative decisionmaking.

### A. *Heavy Regulation*

The scenario that most visibly manifests the uncertainty or reasonableness thesis is the heavily regulated industry. In a context of heavy

regulation, the state "occupies" not only those matters within a field it *specifically* regulates, but *all* aspects of the field.[172] The state thus defines the area as one in which it has a particular interest. Under the field occupation model, contracting parties constructively acknowledge this prominent element of public control, as well as the uncertainty it entails.[173] By placing the onus of accounting for legal change on the market actor, the field occupation model removes heavy regulation from the purview of the Contract Clause. Thus, in the heavily regulated industry, the private actor suffers no unfair surprise by the introduction of "subsequent amendments to achieve the legislative end."[174]

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172. *See supra* section II.A.

173. *See supra* section II.A.

174. Federal Housing Admin. v. Darlington, Inc., 358 U.S. 84, 91 (1958). The reader should note at this point that government contracts present an anomaly for the field occupation model. Under the model's reasoning, a government contract would fall somewhere in the range of a heavily regulated industry because the state speaks directly to subject matter of the contract. However, there are qualitative differences between regulation and contract which render the heavily regulated industry model inapplicable to a government contract scenario. In a regulation context, the state seeks to exercise its authority as an institution, thereby giving rise to "obligation." In a contractual context, however, the state operates as any other private actor might operate.

> 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. . . . A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity.

Murray v. City of Charleston, 96 U.S. 432, 445 (1877).

Although government contract contexts are qualitatively different from the others listed, one *could* argue that the field occupation model applies to government contracts. The state does not occupy a field by contracting in that industry. Rather, the state implicitly asserts that it does not seek to act in that area as an authority, but instead as a market actor. By surrendering its position of authority, the state affirmatively de-occupies, or vacates the field for the purposes of that transaction. The state thus contracts with an eye toward inducing reliance, giving rise to reasonable expectations.

Although this inducement will not ab initio render a subsequent repeal invalid, City of El Paso v. Simmons, 379 U.S. 497 (1965) (holding statute modifying state's obligation only by limiting defaulting purchasers' ability to reclaim property does not violate Contract Clause); Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942) (holding statute modifying state's own municipal bond obligation valid under the *Blaisdell* test), it will deprive the legislature of any claim that it sought to exercise dominion over an industry by the prior legislative action. An assertion of control of an area must arise from a condition or act outside of the contract. The courts have therefore treated parties differently based on the persona the state adopts in its action. *Cf.* NOWAK & ROTUNDA, *supra* note 15, at 406-07. Courts will accord regulation preferential treatment under the general rule, while scrutinizing modification of government contracts for validity on an act-by-act basis.

By way of illustration, the reader might contrast United States Trust Co. v. New Jersey, 431 U.S. 1 (1977), with the heavily regulated industry cases. In *United States Trust,* the Court's analysis focused on the notion that "a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives. Similarly, a State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well." 431 U.S. at 30-31. The circumstances surrounding the repeal did not justify the repeal in terms of either reasonableness or necessity. The Court thus invalidated the contractual impairment. The Court, in finding that the legislation violated the Contract Clause, emphasized the fact that the state sought to modify its own contractual obligations. 431 U.S. at 23. Unlike other instances in which a state exercises its reserved powers to impose retroactive effects on market actors, a state's efforts to modify its own financial obligations does not deserve

Heavy regulation also presents the easiest case for the field occupation model. Here, the state's method of occupation is both active and apparent; an extensive scheme of regulation is in place and enforced. Parties are constructively aware of the state's interest in the field by virtue of their submission to these laws. While questions may arise concerning the breadth of the heavy regulation, a Contract Clause challenge will fail once a court finds that the private party has contracted in a heavily regulated industry.

An examination of *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*[175] from a field occupation standpoint illustrates how the model would treat HRID scenarios. In *Energy Reserves Group,* the Court upheld a Kansas statute regulating natural gas prices.[176] As the Court noted in its opinion, natural gas producers had long been subject to "extensive and intrusive" state regulation.[177] For field occupation purposes, this fact alone would have removed the Kansas natural gas industry from the Contract Clause's zone of protection. The comprehensive nature of the legal scheme rendered unreasonable any expectation of legal consistency. In this respect, the model's treatment of *Energy Reserves Group* differs from the Court's. Although the Court considered such balancing factors as the extent of contractual impairment, the existence of a legitimizing public purpose, and the reasonableness of the impairment,[178] field occupation looks only to the presence of thorough state action to deny relief under the Contract Clause.

### B. *Reserved Powers*

The field occupation model also requires a market actor to recognize and account for the uncertainty created by the police and eminent domain powers. In this regard, the model relies on much the same logic as the implied term doctrine embodied in *Stone v. Mississippi*[179] and *West River Bridge Co. v. Dix.*[180] The reader will recall that, in both these decisions, the Court read into all contracts a term that the state could at any time impair the contract in the exercise of the state's

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the degree of deference usually accorded such exercises. The Court therefore looked closely at the reasonableness and necessity of the repudiation of the state's obligation. 431 U.S. at 29-32 ("[A] State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors.").

Thus, in spite of the apparent ill fit of government contracts to the field occupation model, the area of government contracts in fact presents merely a special category for the model.

175. 459 U.S. 400 (1983).

176. 459 U.S. at 413-16. For a full discussion of *Energy Reserves Group,* see *supra* notes 119-22 and accompanying text.

177. 459 U.S. at 414 & n.18.

178. 459 U.S. at 411-13.

179. 101 U.S. 814, 821 (1879).

180. 47 U.S. (6 How.) 507, 532 (1848).

reserved powers.[181] Regardless of a legislature's prior acts or prior failure to act, because the state holds inalienable power over matters of police and property, the state at all times occupies these fields. Even if the state should attempt explicitly to abandon one of these powers, a resumption of that power is wholly within the state's right.[182] All contracts are subject to this continuing occupation. Thus, the field occupation model invalidates a party's claim of unfair surprise should the exercise of a reserved power contravene an obligation in the party's contract.

As with heavy regulation, a court can easily determine the constitutionality of a reserved powers statute under the field occupation model. Although the reserved powers' manner of occupation is not necessarily active, the occupation is apparent. The powers of police and eminent domain are explicit and ever present. Unlike heavy regulation, a private party does not acknowledge the reserved powers by conducting business in a regulated area. Rather, through their status as citizens in the constitutional scheme, market actors submit to the states' Tenth Amendment powers.

If a court finds a contract to fall within a state's reserved powers, field occupation defines the contracting party's expectation of stability to be unreasonable and therefore unprotected. For instance, in *Stone v. Mississippi*,[183] the Court addressed a challenge to a statute revoking a lottery charter. Under the field occupation model, the Court would have determined whether lotteries were among those areas properly regulated under the police power. Upon finding that lotteries affect the health, safety, or morals of the populace, the Court would have upheld the legislation, because an expectation that the state could not exercise its police power is illegitimate and therefore unreasonable. Given the similarities between field occupation and implied term methodology, it is not surprising that this process is largely the same as that which the Court followed in *Stone*.

### C. *Public Purpose Occupation*

Public purpose occupation is the third category of field occupation. Here, no prior state action or inalienable power supports a current exercise of state power. Nonetheless, an expectation that the legislature will not act still would be unreasonable under "public purpose occupation" if the court finds that the contract implicates important public concerns. The discussion below sets out some of the considerations that would permit such a finding.

As *Blaisdell*[184] and its progeny demonstrate, a greater possibility

181. *See supra* section I.A.

182. *See supra* note 61 and accompanying text.

183. 101 U.S. 814 (1879).

184. 290 U.S. 398 (1934) (discussed *supra* in notes 65-74 and accompanying text).

of unfair surprise exists when the state seeks to legislate in an area it has not traditionally controlled than in an area in which the state has previously declared its interest.[185] These decisions, however, recognize that states need to provide for the common weal in matters besides health, safety, or morals.[186] A state will have important interests in protecting itself and its citizenry in areas including, inter alia, employment relations,[187] environmental issues,[188] and economic hardship.[189] In this context the Court faces the need to allow the states "to protect their fundamental interests."[190]

While a legislature's efforts to "[e]nter[] a field it ha[s] never before sought to regulate"[191] increase the likelihood of unfairness, this fact alone should not end the analysis.[192] The legislature still suffers from a "bias toward the near"[193] and all the frailties entailed in prospective decisionmaking.[194] An absolute bar against retroactive lawmaking beyond reserved powers and heavy regulation would ignore this phenomenon and ultimately deprive the state of an important, perhaps necessary, power.

To avoid such a result, the Court has opted to engage in an ad hoc

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185. *See, e.g.*, Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 245-47 (1978) (discussing the absence of state regulation in the area as giving rise to unfair surprise).

186. *See supra* section I.B.

187. *See* General Motors Corp. v. Romein, 112 S. Ct. 1105 (1992).

188. *See* Keystone Bituminous Coal Assn. v. DeBenedictis, 480 U.S. 470 (1987).

189. *See* Home Bldg. & Loan Assn. v. Blaisdell, 290 U.S. 398 (1934).

190. *Blaisdell*, 290 U.S. at 443-44.

191. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 249 (1978).

192. It may strike the reader as perverse that when a prior legislature has not passed legislation in a field that it binds its successors, while prior enactments free a successor legislature to act. *See* Eule, *supra* note 153, at 452-53 (contrasting *Allied Steel* and *Veix*).

Professor Eule refers to these unregulated fields as "vacant lots." One problem Eule finds regarding vacant lots is whether they are left vacant by "design or by inattention." *Id.* at 453. "The task, therefore, is one of giving content to legislative silence. Should a history of legislative inactivity be construed to signal approval of the status quo or treated as devoid of meaning? Imparting content to the failure to speak is surely among the most futile of endeavors." *Id.* (footnote omitted).

Let us assume, however, that, prior to the enactment of the statute in *Allied Steel*, in which the Court struck down a Minnesota law modifying existing pension agreements, all employers similar to Allied had pension plans roughly along the lines mandated by the statute. At that time, then, the industry norm is the same as that dictated by the new law. In this context, how could Allied assert that legislative silence endorsed its extant plan? The maintenance of the status quo rationale would not help here.

Let us further assume that, without directly dictating conduct, the state provided incentives to employers to adopt plans similar to those later mandated. There is regulatory silence on the matter, but the state has a clearly enunciated policy preference. The only basis for reliance a market actor might have in this context is the expectation that compliance with the policy would remain voluntary. It is unclear whether the Court would have found reasonable reliance in *Allied Steel* given these hypothetical facts. However, the element of uncertainty introduced by the government action makes such a finding much more strained than it would be in the absence of that action.

193. *See* PARFIT, *supra* note 137, at 159.

194. *See supra* section II.C.1.

balancing of public and private interests. The factors enumerated in *Energy Reserves Group* permit a state to serve its legitimate ends when the contractual impairment is insubstantial, when the law serves a significant public purpose, and when the means are narrowly tailored to the ends.[195] These factors, however, contemplate issues beyond those for which a party might provide in a risk calculus, and thereby disregard the Contract Clause's purpose of protecting reasonable expectations.[196]

The question then becomes how to provide for public initiatives while maintaining consistency with the clause's focus on expectations. In order to account adequately for the state's need to effect important public policies, the Court should force the private actor to consider the societal effects of the transactions into which it enters. Such a practice will inform the party's prediction of potential future government action.

The relevant concern for the field occupation model is the "public purpose" element. The model's view of reliance would require a court to consider the potential public effects of a private party's business when that business or class of business affects or might foreseeably affect the broader public interest *at the time of contracting.* Although any transaction will entail some externalities, field occupation looks only to those enterprises that affect broad classes of state interests. For instance, if a private party conducts business in a field that affects great numbers of people or substantially affects a somewhat lesser number, that party should reasonably predict that the legislature might likely regulate the field at some point. Further, the model encourages the market actor to look beyond her own operations to the industry as a whole. A practice of a single market actor might not significantly affect broad sectors, but that practice applied on an industry-wide basis might do so. The larger the segment of the population the actor affects by her practices, products, or employment, the greater the likelihood that the state will have an interest in regulating that actor. By recognizing the public nature of a market actor's transactions, this portion of the field occupation model carves out an area in which *foreseeable, potential* state action destroys the reasonableness of an expectation of legal stability.

Public purpose occupation provides the most difficult context for the field occupation model. In contrast to both heavy regulation and reserved powers occupation, this category's manner of occupation is both inactive and latent. There is no prior legislative activity in the

195. *See supra* note 15 and accompanying text.

196. For instance, an examination of whether a statute substantially impairs a market actor's contract ignores the issue whether that impairment might reasonably have been expected. Rather, this element of the Court's test would legitimize a state act on the basis of increments of effect.

area, and no broad legal rule or convention exists to notify a party of a state interest. Therefore, a court's determination of public purpose occupation will entail line drawing on a case-by-case basis more frequently than will the other two forms of occupation. Once a court finds a field occupied, however, the court will treat the contract the same way it would a heavy regulation or reserved powers contract. Under the model, the contract will not receive Contract Clause protection.

Given the considerations listed above, the Court may have wrongly decided *Allied Structural Steel v. Spannaus,* where it struck down a Minnesota pension law that impaired prior pension agreements.[197] Although no prior state regulation governed the pension plans at issue in *Allied Steel,* various factors may have suggested that Allied had reason to expect regulation. For instance, if operations involving one hundred or more employees employed the majority of the citizens of Minnesota, the public nature of the employment relations would give rise to a corresponding legislative interest. Further, if the industry practice in pension plans did not serve the needs of employees as well as the Allied plan did, Allied should have recognized this fact. Allied should then have incorporated into its risk calculus the possibility that the public effects of the industry practice would instigate regulation. Finally, because employee-protection regulation was pervasive, Allied might reasonably have expected that pension plans specifically would become a subject of such regulation.[198] Although the presence of a single one of these factors might or might not have given rise to a field occupation in *Allied Steel,* an examination of the totality of the circumstances surrounding Allied's contract demonstrates that Allied's expectations were perhaps unreasonable.

This approach to "vacant lot" scenarios permits the state to exercise its powers retroactively in fields not previously designated as occupied, but only when that exercise serves a sufficiently public purpose. Further, it does so in a manner geared toward the Contract Clause's original purpose of protecting reasonable expectations. The model creates a central focus for Contract Clause jurisprudence, thereby doing away with the current piecemeal standard in favor of a more holistic approach.

### D. *Field Occupation versus Balancing*

The field occupation model provides several benefits over a balancing standard. First, by focusing on reliance, field occupation maintains a methodological continuity with the pre-*Blaisdell* decisions.

197. For a full discussion of Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978), see *supra* notes 88-95 and accompanying text.

198. *See Allied Steel,* 438 U.S. at 261 n.8 (Brennan, J. dissenting) (indicating the pervasiveness of employee-protection regulation).

Indeed, field occupation functions as a natural extension of the reserved powers decisions in the mid- to late-nineteenth century. The model's adoption of essentially an implied term rationale flows from *Stone* and *West River Bridge Co.* in a manner that achieves *Blaisdell's* goal of permitting a broader range of state action, but without the "modern" methodology.

Further, the field occupation model imposes on both individuals and legislatures a measure of rigor the balancing standard fails to provide. In order to state a Contract Clause claim under the model, market actors must ensure before entering a transaction that they have considered all relevant factors. Not only must they contemplate prior government action, they must also account for potential public effects of their enterprises. Legislatures, without the ever-present possibility of winning in a court's balancing of interests, will have an incentive to exercise greater care in drafting statutes to avoid defeating reasonable expectations. Although states still enjoy broad latitude under the field occupation model, legislatures, if their regulations impair contracts, must ensure that their product addresses matters of public import, and even then, matters which a market actor should have expected upon entering into a transaction to be public in nature.

Finally, field occupation provides broad and clear standards on which an actor might base her risk calculus. In spite of its tolerance of uncertainty, the model injects greater certainty into the judiciary's treatment of Contract Clause challenges than does the current balancing test. The model limits the judicial discretion entailed in the post-*Blaisdell* Contract Clause jurisprudence, in which the clause's applicability depends largely on who conducts the balancing. Although some discretion remains in a court's definition of public purpose occupation, the field occupation model provides a measure of predictability and consistency absent from recent decisions.

## CONCLUSION

With its adoption of a balancing test to address Contract Clause problems, the Supreme Court has diverged from the clause's purpose of protecting expectations. This departure from the Court's early reliance-based approach has deprived the clause of the clarity and certainty it once possessed.

One element of the Court's current test, however, represents a return to an emphasis on reasonable expectations. The heavily regulated industry doctrine reasons that a private actor who conducts business in an area subject to a pervasive legal scheme cannot expect to avoid the effects of a change in that scheme. The doctrine rests on the notion that in order for a reliance claim to receive Contract Clause protection, that reliance must at least be "reasonable." Further, the

doctrine finds its roots in the fluid nature of a popular sovereign, as well as in the legislature's inalienable powers.

Using the heavily regulated industry doctrine as a springboard, the above analysis demonstrates the Supreme Court should predicate its treatment of all Contract Clause challenges on whether the state has asserted or was likely to assert control over a field. This control may manifest itself in three ways, ranging from "heavy regulation," whereby the state governs substantially all aspects of a field, to "reserved powers," when the Constitution grants to the state power over a field, to "public purpose" occupation, under which the state has an interest in a field and therefore might foreseeably regulate a matter. Although the Court has never based a decision entirely on this aspect of a legislative act, the opinions are generally consistent with the perspective taken in the field occupation model, if only because the Court has never invalidated a statute aimed at a heavily regulated industry.

In determining the legitimacy of a party's assertion of unfair surprise, the model suggests that the Court should require that party, when engaging in her risk calculus, to look beyond the isolated transaction to the possibility of governmental action. A requirement of adequate, though not necessarily accurate, prediction accords with the Contract Clause's original purpose of protecting reasonable expectations, while permitting the state to legislate in areas it deems necessary to serve the public good.

The field occupation model provides a coherent basis for the Court's determination of reasonableness in light of its dual goals. By delineating zones of uncertainty, the model simplifies the Contract Clause test to the issue of reliance. Further, by recognizing the various factors a party should consider in its risk calculus, it puts market actors on notice as to the possibility of legislative interference with their contracts when the public character of those contracts is sufficiently great.