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Leasing Sovereignty: on State Infrastructure Contracts

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LEASING SOVEREIGNTY: ON STATE INFRASTRUCTURE CONTRACTS

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I. INTRODUCTION: INFRASTRUCTURE PRIVATIZATION CONTRACTS

Infrastructure privatization is in the news.[2] Pennsylvania, California, Colorado and Indiana, among many other states and municipalities, have in the past ten years privatized—or attempted to privatize— toll roads, parking meters and other public infrastructure.[3] State and federal policy has encouraged these

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[2] *See, e.g*, Mick Dumke, *Mayor Daley Pitches Chicago in Asia, but Who Is Buying*? N.Y. TIMES, Nov. 13, 2010, *available at* www.nytimes.com/2010/11/14/us/14cncpulse.html (describing Mayor Daley's attempt to find foreign investors for Illinois infrastructure projects); *see also* Caitlin Devitt, *Indianapolis Plan to Lease City's Parking Meters Wins Approval*, AM. BANKER, Nov. 17, 2010, at 28 (reporting Indianapolis plan to lease parking meters to private company for fifty years); Jenny Anderson, *Cities Debate Privatizing Infrastructure*, N.Y. TIMES, August 26, 2008, *available at* http://www.nytimes.com/2008/08/27/business/27fund.html?pagewanted=all (reporting that large firms amassed $250 billion to finance infrastructure privatization deals in the U.S. and abroad); Darrell Preston, *Morgan Stanley Group's $11 Billion Makes Chicago Taxpayers Cry*, BLOOMBERG, *available at* http://www.bloomberg.com/news/2010-08-09/morgan-stanley-group-s-11-billion-from-chicago-meters-makes-taxpayers-cry.html ("Chicago drivers will pay a Morgan Stanley-led partnership at least $11.6 billion to park at city meters over the next 75 years, 10 times what Mayor Richard Daley got when he leased the system to investors in 2008."); Emily Thornton, *Roads To Riches: Why Investors Are Clamoring to Take Over America's Highways, Bridges, and Airports—And Why the Public Should Be Nervous*, BUSINESSWEEK, May 7, 2007, *available at* www.businessweek.com/magazine/content/07_19/b4033001.htm ("In the past year, banks and private investment firms have fallen in love with public infrastructure. They're smitten by the rich cash flows that roads, bridges, airports, parking garages, and shipping ports generate—and the monopolistic advantages that keep those cash flows as steady as a beating heart.").

[3] Ellen Dannin, *Crumbling Infrastructure, Crumbling Democracy: Infrastructure Privatization Contracts and Their Effects on State and Local Governance*, 6 NW. J. L. & SOC. POL'Y 47 (2011); *see also* Celeste Pagano, *Proceed With Caution: Avoiding Hazards in Toll Road Privatizations*, 83 ST. JOHN'S L. REV. 351 (2009) (discussing infrastructure privatization in Indiana, Illinois, Virginia, Colorado, Florida, Mississippi and Texas); Phineas Baxandall, PRIVATE ROADS, PUBLIC COSTS: THE FACTS ABOUT TOLL ROAD PRIVATIZATION AND HOW TO PROTECT THE GOVERNMENT (U.S. PIRG Education Fund 2009) *available at* http://cdn.publicinterestnetwork.org/assets/H5Ql0NcoPVeVJwymwlURRw/Private-Roads-Public-Costs.pdf. (providing a snapshot of infrastructure privatization proposals); U.S. DEPARTMENT OF TRANSPORTATION, OVERVIEW OF STATE P3 LEGISLATION, *available at* http://www.fhwa.dot.gov/ipd/p3/state_legislation/state_legislation_overview.htm (surveying public-private enabling legislation in 26 states).

public-private partnerships and infrastructure privatization.[4] We've been here before. Private development of public infrastructure was common in states and municipalities in the nineteenth century.[5] This was typically done through granting corporate charters and franchises.[6] Widespread disillusionment with this model led to a public finance counterrevolution in the twentieth century.[7] Privatization re-emerged in the 1980s and 1990s.[8] Headlines such as "Why Does Abu Dhabi Own All of Chicago's Parking Meters?" and "Cities for Sale" attest to the continuing controversy surrounding these arrangements.[9]

Ellen Dannin has furnished the most extensive academic critique of infrastructure privatization contracts to date.[10] The typical agreement can run over a hundred pages, span the better part of a century, and includes contract terms that make the public the guarantor of the contractor's risk.[11] Such provisions curtail otherwise routine exercises of sovereign power in order to protect the

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4 For a discussion of the federal policies encouraging infrastructure privatization, see Baxandall *supra* note 3,at 13–15. *See also* Dominique Custos & John Reitz, *Public-Private Partnerships*, 58 AM. J. COMP. L. 555, 557–58 (2010) (discussing the fragmented legal landscape of public-private partnerships).

5 Custos & Reitz, *supra* note 4, at 567 ("The nineteenth century saw substantial state subsidization of private enterprises laying down the backbones of American utilities.").

6 Custos & Reitz, *supra* note 4, at 568 ("Under franchise contracts passed with private corporations, their financial aid came in six ways: cash payments, loan of credit, bond issuance, purchase of shares in the corporation, tax-exemption and in the case of railroads, land grants.").

7 David E. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 265 (1963) ("The widespread disillusionment resulting from the excesses of the railroad bond era of the nineteenth century caused a constitutional revolution among the states. New limitations on the financial powers of the states and their political subdivisions were adopted, including express restrictions on government economic aid to private enterprises. At the same time, the judiciary evolved a public purpose doctrine to complement the new constitutional provisions.").

8 Custos & Reitz, *supra* note 4, at 562.

9 Max Fisher, *Why Does Abu Dhabi Own All of Chicago's Parking Meters?*, THE ATLANTIC WIRE, October 19, 2010, *available at* http://www.theatlanticwire.com/business/2010/10/why-does-abu-dhabi-own-all-of-chicago-s-parking-meters/18627/ (describing potential loss of control of Chicago's parking meters to foreign owners); *see also* Bethany McLean, *Cities for Sale: Psst! Wanna Buy the New Jersey Turnpike?*, SLATE, March 15, 2011, *available at* http://www.slate.com/articles/business/moneybox/2011/03/cities_for_sale.html (discussing lack of transparency and conflicts of interest between banks advising cities regarding the feasibility of privatization and banks as profiting from those same deals); Yves Smith, *Durbin Bill Designed to Throw Wrench in Wall Street Infrastructure Heist*, NAKED CAPITALISM, June 18, 2011, *available at* http://www.nakedcapitalism.com/2011/06/durbin-bill-designed-to-throw-wrench-in-wall-street-infrastructure-heist.html ("It is key to understand what a bad deal these transactions are for ordinary citizens. In addition to having sizeable up front fees, the return requirements are well in excess of the government entities' borrowing rates, typically just under 20% . . . . On top of that, the deals also impose serious restrictions on government sovereignty and often have extremely unfavorable clauses that serve to guarantee the investors' returns.").

10 *See* Dannin, *supra* note 3.

11 *Id.* at 54, 67.

contractor's revenue stream.[12] Dannin identifies three clauses designed to reduce contractor risk by limiting the range of government action. First, "compensation event" clauses require the government to pay the contractor when certain triggering events occur, such as an emergency road closure. Second, non-compete clauses prevent the government from building or repairing competing infrastructure. Third, the contractor retains the right to object to government decisions that affect the profitability of the contract.[13] Each of these provisions requires the government to exchange some quantum of sovereign power for up-front cash payments desperately needed to cover short-term budget gaps—a need all the more acute in the aftermath of the financial and real estate crises.[14]

This paper focuses on one of the more troubling features of infrastructure contracts: non-compete clauses. One such clause, discussed below, forbade road improvements that would divert traffic away from the leased toll road.[15] The Chicago parking meter concession, to take another example, required the city to pledge that it would not build additional parking meters within one mile of the concessionaire's leased meters.[16] The relevant legal principles include the Contracts Clause, the reserved powers doctrine, legal prohibitions on alienating sovereignty and the inherent police powers of the state.[17] I conclude that the non-compete terms run afoul of deeply-rooted common law and constitutional principles. If I am right in this, it follows that infrastructure contracts ought to preclude terms that permit the alienation of sovereignty. To be sure, what counts as an "alienation of sovereignty" will not always be obvious.[18] Governments as a general rule must fulfill their contract obligations.[19] But this general, abstract

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12 *Id.* at 55.

13 *Id.* at 50.

14 *Id.* at 51 ("States and cities are also using the up-front payments that are part of many infrastructure privatization deals to address their budget deficits.").

15 *Id.* at 49.

16 *See* Chicago Parking Meter Concession Contract, Section 3.12. Competing Off-Street Parking, *infra* Appendix.

17 A recent article proposes reading the Chicago parking meter deal as an improper conveyance under the *Illinois Trust* public trust doctrine. *See* Ivan Kaplan, *Does the Privatization of Publicly Owned Infrastructure Implicate the Public Trust Doctrine? Illinois Central and the Chicago Parking Meter Concession Agreement*, 7 NW. J. L. & SOC. POL'Y. 136 (2012).

18 Major Bruce D. Page, Jr., *When Reliance Is Detrimental: Economic, Moral and Policy Arguments for Expectation Damages in Contracts Terminated for the Convenience of the Government*, 61 A.F. L. REV. 1 (2008) ("The distinction between government-as-contractor and government-as-sovereign is ephemeral and cannot fairly be established by courts analyzing contracts post hoc") (citing *United State v. Winstar Corp.*, 518 U.S. 839, 894 ("[W]e have already expressed our doubt that a workable line can be drawn between the Government's 'regulatory' and 'nonregulatory' capacities.")).

19 Kyle Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129, 1146 (1996) ("If we allowed the government to break its contractual promises without having to pay compensation, such a policy would come at a high

rule is subject to a limiting principle. On the one hand, the government acts as sovereign trustee of the public interest. In this capacity, government is a public actor with a certain degree of trumping power over private interests. On the other hand, when the government enters the market arena it is cast as an equal counterparty in a commercial contract.[20] In this capacity, government resembles and is expected to behave as a reciprocally bound private actor. But this resemblance is often illusory. Unless our ancient anchor terms are hopelessly circular the essence of government remains public and not private.[21] Because the government is not just a private party, advancing the broader public interest—however difficult to define—is not precisely symmetrical with advancing aggregate private interests. In other words, "efficiency" notwithstanding, the government cannot auction off its power to govern. Longstanding legal norms limit the scope, duration and subject matter of public-private contracts. States contemplating public-private infrastructure deals should think twice before selling the public birthright for a mess of pottage.[22]

II. THE DEBATE OVER STATE PUBLIC-PRIVATE INFRASTRUCTURE CONTRACTS

The 2007 Minneapolis bridge collapse focused public attention on America's disintegrating infrastructure.[23] Many states and municipalities are

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cost in terms of increased default premiums in future government contracts and increased disenchantment with the government generally"); *see also* Perry v. United States, 294 U.S. 330, 350–54 (1935) ("The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen.") (quoting *Sinking Fund Cases*, 99 U.S. 700, 718–19 (1878)).

[20] David B. Toscano, *Forbearance Agreements: Invalid Contracts for the Surrender of Sovereignty*, 92 COLUM. L. REV. 426, 426 (1992).

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[22] Genesis 25: 32-33.

[23] *See* Pagano, *supra* note 3, at 356 (2009) ("The disastrous Minneapolis bridge collapse on August 1, 2007 brought to the nation's attention a problem that had been growing for some time: Our nation's bridges and highways are quite literally crumbling."); *see also* AM. ASS'N OF STATE HIGHWAY & TRANSP. OFFICIALS, *Bridging the Gap: Restoring and Rebuilding the Nation's Bridges* 2 (2008), *available at* http:// www.transportation1.org/BridgeReport/docs/BridgingtheGap.pdf (discussing Minneapolis bridge collapse); Nicholas J. Farber, Note, *Avoiding the Pitfalls of Public Private Partnerships: Issues To Be Aware of When Transferring Transportation Assets*, 35 TRANSP. L.J. 25, 26 (2008) ("The tragic collapse of the I-35W bridge in Minneapolis brought a great deal of attention on our country's deteriorating transportation infrastructure and problems concerning its maintenance and repair."); Susan Saulny & Jennifer Steinhauer, *Bridge Collapse Revives Question About Spending*, N.Y. TIMES, Aug. 7, 2007, at A1 (the bridge collapse "has focused national attention on the crumbling condition of America's roadways and bridges — and on the financial and political neglect they have received in Washington and many state capitals."); BARRY B. LEPATNER, TOO BIG TO FALL: AMERICA'S FAILING INFRASTRUCTURE AND THE WAY HOME (2010) (arguing that the United States is in need of trillions of dollars worth of infrastructure repairs and maintenance); Eric Kelderman, *The State of the Union—Crumbling*, January 16, 2008, *available at* http://www.stateline.org/live/details/story?contentId=270952 ("More than one in four of America's nearly 600,000 bridges need significant repairs or are burdened with more traffic than they were designed to carry . . . . A third of the country's major roadways are in sub-

betting on privatization to fill the gap left by perennial budget shortfalls, state constitutional debt limits and the thorny politics of taxation.[24] These constraints on sound public finance may stymie even good faith attempts to rebuild the nation's failing infrastructure. The financial crisis has, of course, only made things worse.[25] Add to this a widespread ideological belief among elites in the superiority of market solutions to public problems and it is no surprise that states and municipalities have turned to cash-rich corporations for infusions of infrastructure capital.[26]

A. Criticisms have focused on financial value and democratic accountability

Privatization has affected American governance at every level.[27] But the policies continue to be controversial.[28] Infrastructure privatization critics in par-

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standard condition . . . . Dams, too, are at risk . . . . Underground, aging and inadequate sewer systems spill an estimated 1.26 trillion gallons of untreated sewage every year, resulting in an estimated $50.6 billion in cleanup costs . . . .").

[24] Julie A. Roin, *Privatization and the Sale of Tax Revenues*, 95 MINN. L. REV. 1965 (2011) (arguing that contemporary privatization arrangements have allowed states to circumvent debt limits imposed on states in the nineteenth century as a response to problems with public-private infrastructure provision); *see also* John Ziegler, *The Dangers of Municipal Concession Contracts: a New Vehicle to Improve Accountability and Transparency*, 40 PUB. CONT. L.J. 571, 572–73 (2011) ("Recently, depressed economies and falling tax revenues have resulted in budget shortfalls for local governments. These shortfalls have threatened local governments' abilities to deliver basic services to their citizens. Many local governments have opted to enter into concession contracts, a type of public private partnership (PPP), to obtain upfront cash infusions, take advantage of private sector financing, and ensure the delivery of services."); Clayton P. Gillette, *Direct Democracy and Debt*, 13 J. CONTEMP. LEGAL ISSUES 365, 371 (2004) ("Virtually every state constitution imposes limits on the amount of debt that its political subdivisions can issue in order to fund capital projects . . . ."); Stewart Sterk & Elizabeth Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1313 ("Today municipal debt limitations are nearly as common a feature in state constitutions as are limitations on state debt.").

[25] Elizabeth McNichol et al., *States Continue to Feel Recession's Impact*, CTR. ON BUDGET POLICIES & PRIORITIES (March 21, 2012), *available at* www.cbpp.org/cms/?fa=view&id=711 ("The Great Recession that started in 2007 caused the largest collapse in state revenues on record."); U.S. Gov't Accountability Office, GAO-08-400, SURFACE TRANSPORTATION: RESTRUCTURED FEDERAL APPROACH NEEDED FOR MORE FOCUSED, PERFORMANCE-BASED, AND SUSTAINABLE PROGRAMS 1 (2008) ("[M]any states and localities are still experiencing declines in revenues due to the effects of the recession. The most recent simulations in our state and local fiscal model show that the state and local government sector continues to face growing long-term fiscal challenges over time, which have been exacerbated by the current recession.").

[26] For a general discussion of market ideology in the context of privatization, *see* Matthew Titolo, *Privatization and the Market Frame*, 60 BUFF. L. REV. 493 (2012).

[27] Donald G Featherstun et. al., *State and Local Privatization: An Evolving Process*, 30 PUB. CONT. L.J. 643, 644 (2001) ("Every facet of governmental function has been touched by privatization.").

[28] *See, e.g.*, Dannin *supra* note 3; *see also* Titolo *supra* note 26; Matt Stoller, *Public Pays Price for Privatization*, POLITICO, (June 8, 2011), *available at* http://www.politico.com/news/

ticular express several concerns. First, the claimed financial benefits of infrastructure contracts are still disputed.[29] For example, financial experts believe that the Chicago parking meter concession contract was a bad deal for the city.[30] Parking rates quadrupled and it was estimated that Chicago could have earned between $670 million and $2 billion more if it had kept the meters public.[31] Second, there is the ever-present possibility of self-dealing and corruption.[32] The mechanics of the contracting process raise red flags. On the contractor's side of the table sit savvy repeat players with much privatization experience, both domestically and internationally.[33] On the government's side of the table, negotiators may lack experience with large scale privatization projects.[34] Third, critics worry about the loss of public control, transparency and democratic accountability.[35] As discussed below, infrastructure contracts typically require the government to give up some control over its policy prerogatives to insure against the contractor's possible losses. Fourth, to secure favorable tax treatment, infrastructure contracts span many years.[36] But these long-term contracts pre-commit

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stories/0611/56525.html ("Privatization takes inherently governmental functions—everything from national defense to mass transit and roads—and turns them over to the control of private actors, whose goal is to extract maximum revenue while costing as little as possible.").

29 *See, e.g.*, Smith, *supra* note 9; *see also* Roin, *supra* note 24, at 1969 ("Debt masquerading as privatization costs governments more than conventional debt . . . . [G]overnments are unlikely to borrow at rates as favorable as the rates they would obtain when issuing conventional debt.").

30 Dan Mihalopolous, *Company Piles Up Profits from City's Parking Meter Deal*, N.Y. TIMES, November 19, 2009, *available at* http://www.nytimes.com/2009/11/20/us/20cncmeters.html?pagewanted=1&_r=1&ref=us&adxnnlx=1258725941-1V%207onrA6MBaXJWQYoz3Uw (reporting that parking meter rates quadrupled and that financial experts believed that the city would have been better off financially if they simply kept the meters).

31 *Id.* (quoting Roger Skurski, Professor of Economics: "Sure, they got the money up front and plugged their budget hole, but on every other score, the city did not get a good deal.").

32 *See* Dannin, *supra* note 3, at 77–82 (discussing the "infrastructure contractor / investor / advisor revolving door.")

33 *Id.* at 77–78.

34 *Id.* at 75.

35 *See generally id.* (describing possible loss of accountability and public control where infrastructure is privatized); *see also* Pagano, *supra* note 3, at 366–78 (discussing problems inherent in privatization including possible lack of democratic control of the process and tension between public and private goals); Craig Anthony (Tony) Arnold, *Privatization of Public Water Services: The States' Role in Ensuring Public Accountability*, 32 PEPP. L. REV. 561 (2005) (describing public opposition to water privatization and advocating that privatization be made accountable to the public).

36 Dannin, *supra* note 3, at 55 ("[S]horter contracts could mean losing the benefit of federal tax provisions that allow contractors to take advantage of the ability to take highly accelerated depreciation of the infrastructure. Those provisions are only available if the contract term is so long it exceeds the useful life of the infrastructure and effectively makes the private contractor the owner."); *see also* Jeffrey N. Buxbaum & Iris N. Ortiz, *Protecting the Public Interest: The Role of Long-Term Concession Agreements for Providing Transportation Infrastructure* 14 (USC Keston Inst., Research Paper No. 07-02, 2007), *available at* http://

future legislatures to specific policy outcomes, thus potentially creating unhealthy and undemocratic entrenchment.[37] Finally, privatization can function as a form of covert taxation by allowing states to circumvent budget limitations imposed by state constitutions and allowing politicians to avoid the unpalatable option of raising taxes.[38] In my view, this has the negative side effect of making it more difficult to have an honest and open debate about taxation for public services.

B. Non-compete provisions have been particularly controversial

From the contractor's perspective, long-term infrastructure deals are risky.[39] For tax reasons, lease terms stretch out for decades.[40] Much can go awry in that time. For example, if a company pays for the right to collect tolls on a road, the financial value of that contract would be reduced—if not eliminated altogether—were the government to build a light-rail system that redirected the flow of commuters to the train. Fewer drivers may be good policy, but it's bad for the contractor's bottom line. Future policy shifts expose the company to serious financial losses. As a result, contractors have insisted on "compensation event" and non-compete clauses in infrastructure privatization agreements.[41] Typically, the government agrees not to build competing public facilities.[42]A more pointed way of putting this: the contractor can seek damages when the government exercises its sovereign prerogative to legislate in the public good.[43] For example, one toll road contract in Commerce City, Colorado, required the government "to lower speed limits and install unnecessary traffic

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www.camsys.com/pubs/Protecting%20the%C20Public%20Interest-Report.pdf ("The ability to depreciate the 'value' of the asset for tax purposes seems to be one of the driving factors behind the longer lease terms in the United States.").

37 Christopher Serkin, *Public Entrenchment Through Private Law*, 78 U. CHI. L. REV. 879, 882 (2011) (citing "long-term public-private partnerships" as a form of private-law entrenchment of earlier policy decisions").

38 *See* Roin, *supra* note 24.

39 Dannin, *supra* note 3, at 55.

40 *Id.*

41 *Id.* at 60–61 (explaining that "noncompete provisions are commonly found in infrastructure privatization agreements, [but] they are not limited to privatized roads" and that investors view these clauses as essential to infrastructure investment.); *see also* Pagano, *supra* note 3, at 374 ("Another related potential source of conflict between a state and a toll road operator arises from the operator's desire to limit competition with the toll road. A private company naturally wants to see a return on its large up front investment, and does not want to see its project underused due to competition from improved free roads. Therefore, concessionaires typically ask state transportation departments to agree not to widen or construct roadways within a certain distance of the toll road.").

42 Following this Article there is an appendix including sample excerpts from the Chicago parking meter concession contract. *See* Section 3.12 in Appendix, *infra*.

43 *See, e.g.*, Chicago Parking Meter Concession Contract, Section 3.12 ("Competing Off Street Parking") included in Appendix.

lights on a road parallel to the E-470 toll highway beginning in 2002. The move was designed to make driving on Tower Road an unpleasant experience, forcing frustrated motorists to pay the toll to get to their Denver-area destination."[44] Such provisions are common in infrastructure contracts in the United States and abroad.[45] Another non-compete technique is "traffic calming," which channels traffic to the for-profit toll road by making traveling by alternative routes slower and more expensive.[46] Other times, as in the controversial express toll lanes on California SR-9, the government must promise not to repair or otherwise maintain nearby "competing" roads.[47] In the case of California SR-9 project, this led to public criticism and a lawsuit.[48]

It is not hard to see why these terms would raise the hue and cry: the government is ceding some measure of control over public policy to for-profit companies. While volumes have been written on privatization generally, there has not been much commentary focusing on the legal status of the infrastructure non-competes.[49] While sovereignty and police powers have been alluded to in the recent literature, the general focus has quite properly been on the financial value of the contracts and on questions of accountability.[50] Scholars have discussed non-delegation and state action in the context of privatization, and have offered excellent suggestions for improving the contracting process and creating a better legal architecture, but have not yet focused on the status of the recent infrastructure non-competes under existing legal doctrine.[51] I fill that lacuna

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[44] *Colorado City Ruins Road to Boost Toll Revenue: Commerce City, Colorado Non-Compete Agreement Lowered the Speed Limit and Installed Unneeded Traffic Signals to Force People onto the E-470 Toll Road*, THENEWSPAPER.COM, Aug. 15, 2005, *available at* http://www.thenewspaper.com/news/05/599.asp.

[45] Dannin, *supra* note 3, at 61.

[46] *Id.* It should be noted that traffic calming is not unique to non-compete contracts.

[47] *Id.*

[48] *Id.*; *see also City of Corona v. State of California Dept. of Transp.* 2003 WL 22332968 at *1 (Cal. Ct. App. 2003) (noting that under the agreement with private contractor challenged by the City of Corona "Caltrans would not add new public lanes to the highway without the agreement of the private toll road operators"); see also Jeffrey Leib, *Toll Firm Objects to Work on W. 160th: The "Non-Compete" Clause for the Northwest Parkway Raises Legislative Concerns*, DENVER POST, July 24, 2008, *available at* http://www.denverpost.com/news/ci_9976830 (describing concerns expressed by Colorado lawmakers regarding non-compete clauses in Northwest Parkway toll road contract);

[49] *See, e.g*, Titolo, *supra* note 26.

[50] *See, e.g*., Dannin, *supra* note 3; *see also* Roin, *supra* note 24.

[51] Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367 (2003) (proposing constitutional analysis of privatization as delegation to private parties under state action doctrine); *see also* Harold Krent, *The Private Performing the Public: Delimiting Delegations to Private Parties*, 65 U. MIAMI L. REV. 507 (2011) (____); Ellen Dannin, *To Market, to Market: Legislating on Privatization and Subcontracting*, 60 MD. L. REV. 249 (2001) (advocating for a more comprehensive legal architecture for privatization to protect the public interest); Ellen M. Ehrhardt, Note, *Caution Ahead: Changing Laws to Accommodate Public-Private Partnerships in Transportation*, 42 VAL. U.L. REV. 905, 948–53 (2008) (discussing four important legal issues in public-private

here by analyzing the legal status of non-competes under the Contracts Clause of the United States Constitution and the related common-law doctrine of inalienable police powers. In the rush to privatize, we have not been careful in creating an adequate legal architecture that protects the public good. I have no ambitions to provide a comprehensive account of infrastructure contracts here. Rather, my more modest aim is to enrich the debate by analyzing one troubling aspect of recent public contracts. The remainder of the Article is therefore divided in two parts. First, I provide an overview of Contract Clause jurisprudence, a doctrinal arc that begins with robust enforcement of the Clause, traces its gradual decline in the late nineteenth and twentieth centuries and sees a minor revival of the Clause in the late twentieth century.[52] I then analyze a fictional non-compete clause in a hypothetical infrastructure contract.[53] I conclude that non-compete clauses raise serious concerns under American law and conclude that states should restrict the scope of non-competes or eliminate them altogether.

III. CONTRACT VERSUS SOVEREIGNTY: THE INALIENABLE POWERS PRINCIPLE

Since the Colonial era, governments at every level have entered contracts for the provision of necessary public goods and services.[54] From the nineteenth century onward, American corporations have been building and maintaining roads and bridges, providing munitions and war materiel, and supplying municipalities with sanitation, electricity and water services along with many other public goods.[55] The provision of public services is often mediated through contract.[56] So "public-private partnerships" are here to stay.[57] Government con-

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enabling legislation: (1) whether the enabling legislation allows unsolicited bids by contractors; (2) whether prior legislative approval of projects is needed; (3) whether the public agency may hire its own consultants; (4) whether the enabling legislation will protect the confidentiality of PPP proposals and pre-contract negotiations.") (citing U.S. Department of Transportation guidelines); Nick Beerman, Comment, *Legal Mechanisms of Public-Private Partnerships: Promoting Economic Development or Benefiting Corporate Welfare?* 23 SEATTLE U. L. REV. 175, 179 (1999) (arguing that there are "legal mechanisms used in public-private partnerships to skirt the constitution violate the public trust . . . .").

52 James W. Ely Jr., *Whatever Happened to the Contract Clause?*, 4 CHARLESTON L. REV. 371, 381 (2010).

53 While there is sample language from real-world infrastructure contracts included in the Appendix, this Article includes a hypothetical contract clause in Section IV *infra* for the sake of simplicity.

54 *See* Chris Sagers, *The Myth of "Privatization"*, 59 ADMIN. L. REV. 37, 52–53 (2007) ("Instances of privatization in the United States are not only old, but have occurred in profusion for a long time. Elsewhere, private service of nominally public ends has occurred extensively and for many centuries.").

55 *Id.*

56 *Id.* at n.53 ("Americans regularly carry out an unusual range of important social functions through nominally non-state associations.").

tracts, however, have always embodied an irreducible tension between two core democratic and rule-of-law principles. David Toscano neatly lays out the basic problem:

> When the government enters into a contract with a person subject to its laws, a tension immediately arises between that person's expectations and the government's need to tailor its actions to the demands of sound public policy. Performing its obligations under a contract requires the government to limit the exercise of some facet of its sovereign power, from the ability to establish budget priorities freely to the prerogative to regulate economic behavior. Thus, enforcing government contracts, especially those that purport to limit future exercises of regulatory powers, is problematic in a democratic political system.[58]

On the one hand, there is an enduring expectation that parties to voluntary agreements will abide by their promised performance.[59] Contracting, after all, is a core institution of modern commercial societies.[60] Nor is the government exempted from these promissory expectations.[61] In one respect, the government can operate on par with the private contractor.[62] Governments, for example, routinely purchase goods from private companies without triggering sovereignty concerns.[63] On the other hand, the government as sovereign has the obligation to

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[57] Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 667 (2000) ("In an era of contracting out, enforceable contracts form the connective tissue between public and private actors; as such, they promise to be important vehicles of policy making.").

[58] Toscano, *supra* note 20, at 426; *see also* David S. Law, *The Paradox of Omnipotence: Courts, Constitutions, and Commitments*, 40 GA. L. REV. 407 (2006) (providing theoretical discussion of the paradox of a legislative power that is at the same time both plenary and able to form self-binding commitments that limit its own plenary power).

[59] *See* CHARLES FRIED, CONTRACT AS PROMISE 1 (1981) ("The promise principle . . . is the moral basis of contract law, is that principle by which persons may impose on themselves obligations where none existed before.").

[60] *See* SIR HENRY MAINE, ANCIENT LAW, 99–100 (1977) ("[W]e may say that the movement of the progressive societies has hitherto been a movement from Status to Contract."); *see also* John Chung, *From Feudal Land Contracts to Financial Derivatives: The Treatment of Status through Specific Relief*, 29 REV. BANKING & FIN. L. 107, 150 (2009) (arguing that as societies modernize, social relations that were once fixed under a status system become "mutable through contract").

[61] *See* Logue, *supra* note 19, at 1146 (1996); *see also Perry v. United States*, 294 U.S. at 350–54.

[62] *See, e.g.*, United States v. Winstar Corp., 518 U.S. 839, 876 (1996) ("[I]t is clear that the National Government has some capacity to make agreements binding future Congresses by creating vested rights . . . .").

[63] *See, e.g.*, *Winstar*, 518 U.S. at 880:

> At one end of the wide spectrum are claims for enforcement of contractual obligations that could not be recognized without effectively limiting sovereign authority, such as a claim for rebate under an agreement for a tax exemption.

legislate in the public good.[64] As the Supreme Court has said: "[w]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms."[65] And this in turn means that governments must retain some degree of freedom to abrogate agreements else it lose its "enduring presence." Thus, government contracts "remain subject to subsequent legislation" by the sovereign.[66] These principles cash out in practice as the following internally inconsistent proposition: governments must retain the unilateral power to break the very same promises we require them to honor. This longstanding tension has never been—and can never be—fully resolved. Nevertheless, it must be resolved in some workable or provisional way if the government would enter into contracts at all. Courts have been struggling with the basic legal tension between sovereignty and contract since the nineteenth century. In Sections III.A-C, I explain the doctrinal framework for analyzing the contract-sovereignty tension as it plays out in the non-compete clauses.

A. Early cases enforce the Contract Clause and reveal the perennial tension between sovereignty and contract

The Contract Clause provides that "No State shall …pass any … Law impairing the Obligation of Contracts..."[67] and supplies the baseline for analyzing the power of state governments to impair public and private agreements.[68]

> Granting a rebate, like enjoining enforcement, would simply block the exercise of the taxing power . . . and the unmistakability doctrine would have to be satisfied. At the other end are contracts, say, to buy food for the army; no sovereign power is limited by the Government's promise to purchase and a claim for damages implies no such limitation. That is why no one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine. Between these extremes lies an enormous variety of contracts including those under which performance will require exercise (or not) of a power peculiar to the Government.

Id.

64 *See, e.g.*, Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 241 (1978) (government has "the sovereign right of . . . to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contract between individuals").

65 Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 52 (1986); *see also Bowen*, 477 U.S. at 52 ("we have declined in the context of commercial contracts to find that a sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in the contract.") (citing *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 148 (1982)).

66 Amino Bros. Co. v. United States, 372 F.2d 485, 491 (1967) ("The Government cannot make a binding contract that it will not exercise a sovereign power, but it can agree in a contract that if it does so, it will pay the other contracting party the amount by which its costs are increased by the Government's sovereign act.").

67 U.S. CONST., art. I, § 10, cl 1.

68 *See* Judith Welch Wegner, *Moving Toward the Bargaining Table: Contract Zoning, Development Agreements, and the Theoretical Foundation of Government Land Use Deals*, 65 N.C. L.

There are several important principles to highlight here. The first is that the Contract Clause applies only to state and local governments and not to the federal government.[69] Second, the Contract Clause is designed in part to prevent state governments from canceling debtor obligations in times of crisis.[70] Third, legislative promises to private parties are contracts within the meaning of the Contract Clause.[71] Fourth, despite its apparently clear and categorical language, courts have not parsed the clause "with literal exactness."[72] Finally, scholars describe a public and a private branch of Contract Clause jurisprudence.[73] This distinction turns on whether the impaired contract was between two private parties or between a private party and the state.[74] Because we are concerned here

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REV. 957, 962 (1987) ("Over two centuries the Contract Clause has comprised a key arena in which tensions between contract obligations and police power needs have been explored, debated, and resolved in many different contexts."); *See generally* B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION (1938). Other relevant doctrines include property concepts such as takings and the public trust doctrine. *See, e.g.*, Stephen A. Siegel, *Understanding the Nineteenth Century Contract Clause: the Role of the Property-Privilege Distinction and "Takings" Clause Jurisprudence*, 60 S. CAL. L. REV. 1, 41–54 (1986); *see also* Michael L. Zigler, *Takings Law and the Contract Clause: A Takings Law Approach to Legislative Modifications of Public Contracts*, 36 STAN. L. REV. 1447, 1452 (1984).

[69] It is easier for the federal government to back out of contracts. It has been settled since the 19th century that Congress can expressly reserve the right to "repeal, alter or amend" contracts with private parties at any time. *See, e.g.*, Congress Bowen v. Public Agencies Opposed To Social Sec. Entrapment, 477 U.S. 41, 53 (1986) (Congress can expressly reserve the right to "repeal, alter, or amend [legislation] at any time") (citing the *Sinking-Fund Cases*, 99 U.S. 700 (1879)). Moreover, the federal government can reserve the right to terminate a contract for convenience. *See* Green Management Corp. v. U.S., 42 Fed. Cl. 411, 436 (1998) ("The government, as a matter of procurement policy, possesses the authority to terminate a contract for the convenience of the government, even in circumstances when a convenience termination clause has been omitted from the contract.") As I explain in Section III.C *infra*, *Winstar* has complicated this principle.

[70] Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 502–03 (1987) ("[I]t is well settled that the prohibition against impairing the obligation of contracts is not to be read literally . . . . [The history of the Contract Clause] indicate[s] that its primary focus was upon legislation that was designed to repudiate or adjust pre-existing debtor-creditor relationships that obligors were unable to satisfy."); Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 256 (1978) ("[The Contract Clause] was made part of the Constitution to remedy a particular social evil—the state legislative practice of enacting laws to relieve individuals of their obligations under certain contracts—and thus was intended to prohibit States from adopting 'as [their] policy the repudiation of debts or the destruction of contracts or the denial of the means to enforce them."); Michael B. Rappaport, Note, *A Procedural Approach to the Contract Clause*, 93 YALE L.J. 918, 932 (1984).

[71] *United States Trust*, 431 U.S. at 17 n.14 (holding that "a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State").

[72] United States Trust Co. of New York v. New Jersey, 431 U.S. 1, 21 (1977) (quoting Home Bldg. and Loan Ass'n v. Blaisdell, 290 U.S. 398, 428 (1935)).

[73] Ely, *supra* note 52, at 381.

[74] Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1604 (1988) ("Distinct 'private' and 'public' branches of contract clause jurisprudence had emerged, each having little to do with the other. The private branch governed state impairment of

with state infrastructure contracts, we will focus on the public branch of the Contract Clause. The doctrinal story is one of robust enforcement in the early to mid-nineteenth century, a slow decline and near nullity in the New Deal period and a minor revival in the late 1970s.[75]

1. Early Cases

The Marshall Court established expansive Contract Clause protection.[76] *Fletcher v. Peck* is the most famous of these early cases.[77] In *Fletcher*, the Georgia state legislature had granted land to several companies in 1795. In 1796, the legislature found that the 1795 grant of land was procured via undue influence and as a result they nullified it.[78] In 1800, Peck attempted to sell to Fletcher land that was part of the original 1795 grant.[79] Peck covenanted that his title to the land had not been impaired by the legislature's 1796 rescission of the original grant.[80] Fletcher alleged that Peck was in breach of this covenant because, among other things, the 1795 legislature lacked the authority to convey the land and the 1796 legislature had in any event rescinded the grant.[81] The Supreme Court rejected this argument, holding that whatever the corrupt motives of the 1795 legislature in conveying the land, once conveyed, the legislature could not rescind the grant.[82] Retroactivity concerns to protect vested rights were at the heart of the court's decision.[83] The Chief Justice stated flatly and as

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previously negotiated contracts between individuals. The public branch governed legislative impairment of state corporate grants and, to a lesser extent, public land grants when the state itself was a party to the bargain for which protection was sought.").

75 *See, e.g.*, Ely, *supra* note 52.

76 Ely, *supra* note 52, at 374 ("As is well known, the Supreme Court, under the leadership of Chief Justice John Marshall, fashioned the Contract Clause into a muscular restraint on state authority.").

77 Fletcher v. Peck, 10 U.S. 87 (1810).

78 *Id.* at 89–90.

79 *Id.* at 87.

80 *Id.* at 88.

81 *Id.* at 126.

82 *Id.* at 130.

83 *Id.* at 138–39. Retroactivity concerns continue to animate Contract Clause jurisprudence. *See, e.g.*, Fed. Land Bank of Omaha v. Arnold, 426 N.W.2d 153, 161 (Iowa 1988) (striking down legislation under the Contract Clause because it retroactively extended the period in which parties could redeem homesteads from foreclosure); *see also* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 250 (1978) (Contracts Clause prohibited retroactive alteration of employee vesting under pension plan); United States Trust Co. v. New Jersey, 431 U.S. 1, 29–30 (1977) (holding that the Contract Clause prohibited "the retroactive repeal of the 1962 covenant.") For a recent discussion of the retroactivity principle, see Ann Woolhandler, *Public Rights, Private Rights, and Statutory Retroactivity*, 94 GEO. L.J. 1015 (2006) (proposing that the categories of public and private can organize and structure retroactivity jurisprudence); *see also* Matthew Titolo, *Retroactivity and the Fraud Enforcement and Recovery Act of 2009*, 86 IND. L.J. 257, 269–79 (2011)

a general principle that "if an act be done under a law, a succeeding legislature cannot undo it."[84] Once granted, the rights have vested.[85]

The Court reaffirmed the vitality of the Contract Clause nine years later in the landmark *Trustees of Dartmouth College v. Woodward*.[86] King George had chartered Dartmouth College in 1769. The original charter granted the trustees the power to hire and remove teachers, set salaries and otherwise be the sole governing body of the college.[87] In 1816, New Hampshire amended the charter of the college by changing the number of trustees, granting the state the power to make appointments and creating a board of overseers and otherwise altering the basic governing structure of the college.[88] These alterations would effectively revoke the 1769 charter. In a lengthy opinion, Justice Marshall reasoned that just as New Hampshire lacked the power to interfere with the original charter grant in 1769, it was powerless to do so years later. After all, if the legislature had effectively revoked the charter grant in 1769, "the perfidy of the transaction would have been universally acknowledged."[89] The original 1769 grant was a contract like any other and as such deserved the protection afforded by the Contract Clause.[90] By completely changing the governing structure of the college, the New Hampshire legislature had impaired the original contract.[91]

But despite the clear *holdings* in the earlier decisions, their *reasoning* reveals the unsolved contract-sovereignty puzzle that remains at the heart of Contract Clause jurisprudence.[92] *Fletcher v. Peck* again provides the template. In the passage quoted above, Chief Justice Marshall declares that a legislature may not undo its earlier acts.[93] However, a contrary statement in the same case

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(discussing the landmark retroactivity decision Landgraf v. USI Film Products, 511 U.S. 244 (1994) and its progeny).

84 *Fletcher*, 10 U.S. at 135.

85 *Id.* ("When a law is in its nature a contract, when absolute rights have vested under that contract, a repeal of the law cannot devest those rights.").

86 17 U.S. 518 (1819).

87 *Id.* at 526–28.

88 *Id.* at 543.

89 *Id.* at 643.

90 *Id.* at 644 ("It is a contract made on a valuable consideration. It is a contract for the security and disposition of property. It is a contract, on the faith of which, real and personal estate has been conveyed to the corporation. It is, then, a contract within the letter of the constitution . . . .").

91 *Id.* at 652–53 ("The founders of the college contracted, not merely for the perpetual application of the funds which they gave, to the objects for which those funds were given; they contracted also, to secure that application by the constitution of the corporation. They contracted for a system, which should, so far as human foresight can provide, retain forever the government of the literary institution they had formed, in the hands of persons approved by themselves. This system is totally changed.").

92 For an extended discussion of the local government cases dealing with this issue, see Janice Griffith, *Local Government Contracts: Escaping from the Governmental/Proprietary Maze*, 75 IOWA L. REV. 277 (1990).

93 *Fletcher*, 10 U.S. at 135.

reveals a crack in *Fletcher*'s Contract Clause architecture: "The principle asserted is, that one legislature is competent to repeal any act which a former legislature was competent to pass; and that one legislature cannot abridge the powers of a succeeding legislature. The correctness of this principle, so far as respects general legislation, can never be controverted."[94] So, on the one hand, once created, a legislative contract right cannot be undone. On the other hand, a later legislature can repeal a prior grant under the guise of "general legislation." Here we have an unresolved conflict of elemental principles. In his concurring opinion, Justice Johnson directly addresses this elemental conflict between contract and sovereignty. He agrees that the state cannot revoke its grants, but sees a deeper and more fundamental problem lurking in the Court's reasoning. It is an ontological feature of sovereignty, (that is, an aspect of the very essence of the concept,) that sovereignty cannot negate itself.[95] Thus, it would be "absurd" and even "suicidal" for the government to assert and negate the same sovereign act (here, by extending a vested property interest in the land grant and then later voiding that same land grant).[96] Moreover, as Justice Johnson suggests, it cannot be the case that the tension between public power and private rights must *always* be resolved in favor of private rights. To set up the rule that way would be to waive the power of eminent domain, a core aspect of sovereignty.[97]

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94 *Id.* at 128.

95 This "self-negating sovereign" paradox has been thoroughly dissected in the academic literature. *See, e.g.*, Law, *The Paradox of Omnipotence*, *supra* note 58.

96 *Fletcher*, 10 U.S. at 143.

97 Some early courts relied on the rights/remedies distinction in an attempt to reconcile the contract-sovereignty problem. *See, e.g.,* Sturges v. Crowninshield, 17 U.S. 122, 200 (1819) (legislature could not retroactively nullify a creditor's *right* to sue in bankruptcy, but it could retroactively alter the *remedy* available to the creditor by, for example, refusing to allow imprisonment of the debtor); *see also* Mason v. Haile, 25 U.S. 370, 378 (1827) (retroactively limiting punishment of bankrupt did not impinge on creditor rights under the Contract Clause); Stocking v. Hunt, 3 Denio 274, 277 (N.Y. Sup. Ct. 1846) ("In the nature of things there is a distinction between the change of a contract and a change of the remedy to enforce the performance of the contract. Under the Constitution of the U.S., the former power is denied to the several States, but the latter exists in full force.") The Supreme Court in *United States Trust*, 431 U.S. 1, n.17 (1977), explains that the rights/remedies distinction cannot provide a bright-line to determine whether the impairment is permissible. However, it might be used as one factor to determine how severe the impairment is based on the reasonable expectations of the parties: "More recent decisions have not relied on the remedy/obligation distinction, primarily because it is now recognized that obligations as well as remedies may be modified without necessarily violating the Contract Clause." *Id.* (citing *El Paso v. Simmons*, 379 U.S., at 506-507, and n. 9 and *Home Building & Loan Assn. v. Blaisdell*, 290 U.S., at 429-435); *Id.* ("Although now largely an outdated formalism, the remedy/obligation distinction may be viewed as approximating the result of a more particularized inquiry into the legitimate expectations of the contracting parties.").

2. Police Powers Jurisprudence and the Decline of the Contract Clause in the late 19th century

Enforcement of the Contract Clause was uneven through the mid-19th century.[98] However, by the 1840s, the balance between contract and sovereignty began to tip more decisively in favor of the latter. The unresolved tension that haunted the earlier cases became impossible to ignore by the mid-nineteenth century.[99] *West River Bridge Co. v. Dix*, marks the turning point.[100] In 1795, the State of Vermont granted the West River Bridge Corporation a 100-year charter to build a toll bridge.[101] By the early 1840s, the toll bridge had become "a sore grievance."[102] Members of the local community petitioned the County Court to remove the bridge.[103] The West River Corporation invoked the Contract Clause. The Supreme Court rejected the company's Contract Clause argument. Justice Daniel wrote: "No State, it is declared, shall pass a law impairing the obligation of contracts; yet, with this concession constantly yielded, it cannot be justly disputed, that in every political sovereign community there *inheres necessarily the right and the duty of guarding its own existence*, and of protecting and pro-

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98 Courts adopted varieties Contract Clause analysis. Sometimes courts enforced the Contract Clause, but with qualifications. *See, e.g.*, Boston & Lowell R.R. v. Salem & Lowell R.R., 68 Mass. 1, 31 (1854) (citing *Fletcher*'s vested rights reasoning to hold that an exclusive thirty-year railroad franchise cannot effectively be nullified by a later grant that impairs the exclusive franchise); *see also* Wash. Bridge Co. v. State, 18 Conn. 53, 64–65 (1846) (holding that unless the state explicitly reserved the right to invalidate earlier grants, the Contract Clause prevented it from doing so); Ogden v. Saunders, 25 U.S. 213 (1827) (Contract Clause bars retroactive interference with contract but does not bar legislature from future-oriented regulations impairing contract obligations). Other courts articulated a police powers rationale for upholding legislative interference with earlier contracts. *See, e.g.*, Charles River Bridge v. Warren Bridge, 36 U.S. 420 (1837) (citing both the principle that public grants should be strictly construed and the intrinsic logic of sovereignty to reject a Contract Clause claim that an earlier franchise granted exclusive rights for a company to run a ferry service); *see also* Mohawk Bridge Co. v. Utica & Schenectady R.R., 6 Paige Ch. 554, 554 (N.Y. Ch. 1837) (holding that "[t]he grant to a corporation of the right to erect a toll bridge across a river, without any restriction as to the right of the legislature to grant a similar privilege to others, does not deprive a future legislature of the power to authorize the erection of another toll bridge across the same river.") Where police power trumped contract, courts sometimes required "takings" compensation. *See, e.g.*, State v. Noyes, 47 Me. 189, 209 (1859) (state grant could not be construed as limiting legislative exercise of sovereignty unless the legislature intended to do this and provided just compensation.); Shorter v. Smith, 9 Ga. 517 522–23 (1851) (legislature could interfere with prior grant where public policy required it as long as compensation was paid); Backus v. Lebanon, 11 N.H. 19 (1840) (allowing state to exercise eminent domain where it had earlier granted a corporation the right to collect tolls on roadway as long as the state paid just compensation). However, as a rule, if a government act is classified as a police power, no compensation is required. *See infra* Section IV.B.3.

99 *See* Griffith, *supra* note 92, at 290.

100 47 U.S. 507 (1848).

101 *Id.*

102 *Id.* at 509.

103 *Id.*

moting the interests and welfare of the community at large."[104] Thus the *West Bridge* Court answered Justice Johnson's concern in *Fletcher* that the Contract Clause read literally negates the inherent power of sovereign government. Note that Justice Daniel expresses the rule here as an ontological one: the sovereign-qua-sovereign must retain trumping power over countervailing interests if it is to survive and promote the "welfare of the community at large."[105] In other words, as discussed below, the government must retain its police power.

This more expansive view of sovereignty had historical and jurisprudential sources. Historically, the late nineteenth century marked the emergence of the American regulatory state.[106] With the emergence of the regulatory state, public power inevitably collided with earlier grants of exclusive corporate franchises through which public functions were mediated.[107] At the same time, critics began to view the Contract Clause as a vehicle to entrench corporate power.[108] Scholars and courts thus invoked with more frequency the ancient "police power" principle. As Thomas M. Cooley explained in his influential 1868 treatise:

> The police of a State . . . embraces its system of internal regulation, by which it is sought not only to preserve the public order and to prevent offences against the State, but also to establish for the intercourse of citizen with citizen those rules of good manners and good neighborhood which are calculated to prevent a conflict of rights, and to insure to each the uninterrupted enjoyment of his own, so far as is reasonably consistent with a like enjoyment of rights by others.[109]

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104 *Id.* at 531 (emphasis mine).

105 *Id.*

106 *See* Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1189 (1986) (the establishment of the Interstate Commerce Commission in 1887 signified that "[t]he modern age of administrative government had begun."); *see also* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 439 (2d ed. 1985) (the creation of the Interstate Commerce Commission marked the "genesis" of the American regulatory state); *but see*, Jerry L. Mashaw, *Federal Administrative Law in the Gilded Age*, 119 YALE. L. J. 1362, 1366 (arguing that the conventional story of an emergent administrative state in the late nineteenth century needs to account for that fact that "the United States was an administrative government from the very beginning of the Republic.") There is an ongoing debate among historians of the regulatory state regarding the chronology that is well reviewed in William J. Novak, *Law and the Social Control of American Capitalism*, 60 EMORY L.J. 377 (2010) (reviewing four distinct views of the emergence and development of the American regulatory state: (1) laissez faire constitutionalism; (2) the capture thesis; (3) "the weakened spring of American government;" and (4) adversarial economic regulation).

107 Ely, *supra* note 52, at 381.

108 *Id.* ("By the dawn of the Gilded Age, prominent scholars and jurists were increasingly skeptical of what they saw as special corporate privileges secured by the Contract Clause.").

109 TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION 572 (1874). The literature on police power is extensive.

A series of cases enshrined the principle that legislative attempts to bargain away police powers are effectively *void ab initio*.[110] Notice that this is different from the "entrenchment" concern that earlier lawmakers not "restrain the power of a subsequent legislature to legislate for the public welfare."[111] Although the term "police power" was first used by the Court in the 1824 case *Gibbons v. Ogden*,[112] and was discussed since the earliest cases,[113] police powers principle became prominent in a series of decisions beginning in the 1870s. *Boyd v. Alabama*[114] was the first of these. The *Boyd* defendant was indicted in Alabama for running a lottery without state authorization but claimed that he had been grant-

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This article does not pretend to provide comprehensive coverage of the concept. For an excellent recent scholarly treatment, see MARKUS DIRK DUBBER, THE POLICE POWER: PATRIARCHY AND THE FOUNDATIONS OF AMERICAN GOVERNMENT (2005) (providing an account of the police power that emphasizes its connection to the plenary powers of patriarchal household governance); *see also* Santiago Legarre, *The Historical Background of the Police Power*, 9 U. PA. J. CONST. L. 745 (2007); David A. Thomas, *Finding More Pieces for the Takings Puzzle: How Correcting History Can Clarify Doctrine*, 75 U. COLO. L. REV. 497 (2004) (furnishing history of the police power from ancient origins that focuses on the power to police public space embodied in the phrase sic utera tuo alienum non laedas); D. Benjamin Barros, *The Police Power and the Takings Clause*, 58 U. MIAMI L. REV. 471 (2004); Griffith, *supra* note 92; HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836-1937, at 28–33 (1991).

110 Robert Hale, *The Supreme Court and the Contract Clause II*, 57 HARV. L. REV. 621, 654 ("A state cannot surrender certain exercises of its police power by contract."); *see also*, Chicago, R.I. & P. Ry. Co. v. Taylor, 192 P. 349, 356 (Okla. 1920) ("As the police powers cannot be surrendered, a contract purporting to do so is void ab initio, and, being void, it is impossible to speak of laws in conflict with its terms as impairing the obligations of a contract."); Butchers' Union Slaughter-House & Live-Stock Landing Co. v. Crescent & Slaughter-House, 11 U.S. 746, 750–51 (1872).("While we are not prepared to say that the legislature can make valid contracts on no subject embraced in the largest definition of the police power, we think that, in regard to two subjects so embraced, it cannot, by any contract, limit the exercise of those powers to the prejudice of the general welfare.").

111 *See, e.g.*, Hale *supra* note 110, at 659 (noting that the holding in *Stone v. Mississippi* was based on an absolute prohibition on alienating sovereignty, not on the legislature's power to bind future legislatures.) Hale takes a somewhat different approach to the "void ab initio" issue. He seems to think that a contract that barters away the police power (what I am here calling "void ab initio") could be adjudicated a valid contract under state late but still held to be unconstitutional. *Id.* at 659. We would do better to view contracts that barter away the police power as failing because the legislature lacked the capacity to enter an illegal contract in the first place: the initial incapacity approach.

112 22 U.S. 1 (1824). The Court first used the term police powers as explicitly referring to the reserved powers of the states in *Brown v. Maryland*, 25 U.S. 419 (1827) ("The completely internal commerce of a State, then, may be considered as reserved for the State itself…[T]he acknowledged power of a State to regulate its police, its domestic trade, and to govern its own citizens, may enable it to legislate on this subject (commerce) to a considerable extent." (quoting *Gibbons v. Ogden*, 22 U.S. 1); *see also* Thomas, *Whither the Public Forum Doctrine?*, 44 REAL PROP. TR. & EST. L.J. 637, 653 (2010) (the Court first used the term police power to refer to the "residual sovereign power of the American states" in *Brown v. Maryland*).

113 *See, e.g.*, Mayor, Alderman and Commonalty of New York v. George Miln, 36 U.S. 102 (1837).

114 94 U.S. 645 (1876).

ed a continuing license to run the lottery under an 1868 act, which had later been repealed.[115] The Supreme Court rejected this defense based on an Alabama high court decision finding the 1868 legislation violated the state constitution's single subject matter provision.[116] The *Boyd* Court took the opportunity to make this succinct observation: "We are not prepared to admit that it is competent for one legislature, by any contract with an individual, to restrain the power of a subsequent legislature to legislate for the public welfare, and to that end to suppress any and all practices tending to corrupt the public morals."[117]

After *Boyd*, courts reinforced this expansive reading of the police power and consequently narrowed the scope of the Contract Clause.[118] The claimant in *Beer Co. v. Massachusetts*, for example, had been granted an 1828 state charter "for the purpose of manufacturing malt liquors."[119] An 1869 liquor prohibition law effectively nullified this earlier grant. Citing *Boyd*, the Court stated that although the boundaries of the police power concept were not clear, "there seems to be no doubt that it does extend to the protection of the lives, health, and property of the citizens, and to the preservation of good order and the public morals. *The legislature cannot, by any contract, divest itself of the power to provide for these objects*."[120] Another lottery case, *Stone v. Mississippi* clarified the emerging consensus view: even where an earlier legislature had granted in clear terms an exclusive right via contract, these rights are not enforceable against a later exercise of sovereign power.[121] This is because "legislatures cannot bargain away the police power of a State."[122] Any legislative act that purports to bind the sovereign power of future legislatures via contract—however clear the terms—is effectively *ultra vires* rendering the earlier purported grant *void ab initio*.[123] On this reading, no compensation would be required because,

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115 *Id.* at 648.

116 *Id.* at 648–49.

117 *Id.* at 650.

118 B. WRIGHT, THE CONTRACT CLAUSE OF THE CONSTITUTION 196 (1938) (find that the Contract Clause declines beginning in the 1860s).

119 97 U.S. 25, 30–31 (1877).

120 *Id.* at 33 (emphasis added)

121 101 U.S. 814, 817-21 (1880).

122 As James Ely notes, there was an exception in this period to grants of favorable tax treatment. Ely, *supra* note 52, at 382–84. He attributes this "anomalous" case to "a respect for precedent." *Id.* For representative cases see Mobile & Ohio R.R. v. Tennessee, 153 U.S. 486, 499 (1894) (treating as well settled the power of Tennessee to grant a tax exemption conferring "either total or partial immunity from taxation, and extend[ed] for any length of time the legislature might deem proper"); *see also* Wash. Univ. v. Rouse, 75 U.S. 439, 441 (1869) (holding that a corporation could continue to assert its contractual right to favorable tax treatment as long as it stayed within the bounds of its original charter); Home of Friendless v. Rouse, 75 U.S. 430, 436–38 (1869) (legislative grant of favorable tax treatment to charity could not be revoked).

123 Fertilizing Co. v. Hyde Park, 97 U.S. 659 (1878) ("[W]e cannot regard [the license] as a contract guaranteeing, in the locality originally selected, exemption for fifty years from the exercise of the police power of the State, however serious the nuisance might become in the future, by

by hypothesis, nothing has been taken. Since the nineteenth century it has been clear that a legislature is powerless to contract away essential attributes of sovereignty.[124]

3. There are two distinct "police power" issues in Contract Clause analysis

The principle that the government may not contract away sovereignty is also referred to as the "inalienable powers" or "reserved powers" principle.[125] It is a close relation to the "public trust" doctrine, which forbids the state from abdicating control over navigable waterways.[126] Some scholars have argued that

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reason of the growth of population around it.") In dissent, Justice Strong objected that such a broad reading of the police power "enables a subsequent legislature to take away, without compensation, rights which a former one has accorded, in the most positive terms, and for which a valuable consideration has been paid." *Id.* at 682. Of course, on the *void ab initio* reading, no compensation would be required precisely because the earlier "grant" was ineffective and hence created no rights in the first place. For the *void ab initio* framing, *see, e.g.*, Butchers' Union Slaughter-House & Live-Stock Landing Co. v. Crescent City Live-Stock Landing & Slaughter-House Co., 111 U.S. 746, 750–51 (1884) (legislature not permitted to bargain away the power to regulate public health and public morals); *see also* State v. Board of Park Comm'rs of City of Minneapolis, 100 Minn. 150, 155 (1907) (contract promising that the state would maintain a parkway free of cost to adjacent landowners was "an attempted alienation of the police power and void"). Even where courts did not explicitly invoke the *void ab initio* language, they gave wide latitude for the legislative exercise of police powers. *See, e.g*, Manigault v. Springs, 199 U.S. 473, 480 (1905) ("It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does not prevent the state from exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected.").

[124] *See, e.g.*, Pierce Oil Corp. v. City of Hope, 248 U.S. 498, 501 (1919); *see also* Atlantic Coast Line R. Co. v. Goldsboro, 232 U.S. 548, 558 (1914) ("[I]t is settled that neither the 'contract' clause nor the 'due process' clause has the effect of overriding the power of the state to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community; that this power can neither be abdicated nor bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise."); Douglas v. Kentucky, 168 U.S. 488, 502–05 (1897) (bargaining away police power would be "destructive of the main pillars of government").

[125] *See generally* Griffith, *supra* note 92.

[126] For an articulation of this principle, see Illinois Ill. Cent. R.R. Co. v. Illinois, 146 U.S. 387, 452–53 (1892):

> [A]bdication of the general control of the state over lands under the navigable waters of an entire harbor or bay, or of a sea or lake… is not consistent with the exercise of that trust which requires the government of the state to preserve such waters for the use of the public. The trust devolving upon the state for the public, and which can only be discharged by the management and control of property in which the public has an interest, cannot be relinquished by a transfer of the property.

Id. See also, Kaplan, *supra* note 17 (arguing that the Chicago parking meter contract violates the public trust doctrine).

this principle is an artifact of history that serves little practical purpose.[127] American courts, however, do not take this view. The core concern of inalienable powers is to prevent the government from delegating too much public authority to private parties.[128] In its broadest articulation, the police powers can simply be described as the inherent power of the legislature to "protect public health, safety, and morals."[129] State constitutions often include clauses that grant the police power to the state and impose an obligation on state officials to guard against encroachments.[130] The police power is distinguished from eminent domain in that if classified as the latter, government action requires compensation where if classified as a police power it does not.[131] Some representative examples from the cases include the power to: regulate the consumption of alcohol;[132] prevent crime;[133] control the public streets;[134] regulate public nuisances;[135] pro-

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127 *See, e g*., Alan R. Burch, *Purchasing the Right to Govern: Winstar and the Need to Reconceptualize the Law of Regulatory Agreements*, 88 KY. L.J. 245, 265 (2000) ("The reserved powers doctrine is essentially an artifact of legal history.").

128 *Bald Head Island Utils. Inc. v. Vill. of Bald Head Island*, 165 N.C. App. 701 (N.C. App. 2004) ("Limitations on these governmental body contractual powers exist to prevent too much authority being delegated away to parties that may not represent the people's best interests.").

129 *Butchers' Union Slaughter-House*, 111 U.S. at 754; *see also* State Farm Mutual Auto Ins. v. Wyo. Ins. Dept., 793 P.2d 1008, 1013 (Wyo. 1990) ("the legitimate objectives of the police power are loosely characterized as being public in nature and the potential range is very broad").

130 *See, e.g*., West Virginia Constitution, Article I-2. Internal government and police.

> The government of the United States is a government of enumerated powers, and all powers not delegated to it, nor inhibited to the states, are reserved to the states or to the people thereof. Among the powers so reserved to the states is the exclusive regulation of their own internal government and police; and it is the high and solemn duty of the several departments of government, created by this constitution, to guard and protect the people of this state from all encroachments upon the rights so reserved.

131 Thomas W. Merrill, *Why* Lingle *is Half Right*, 11 VT. J. ENVTL. L. 421, 426 ("Critically, the Takings Clause (and parallel state constitutional provisions) requires that any exercise of the power of eminent domain be attended by the payment of just compensation to the person whose property is taken. An exercise of the police power, in contrast, is understood not to require any payment of compensation.").

132 *See, e.g., Beer Co*., 97 U.S. at 32 ("If the public safety or the public morals require the discontinuance of any manufacture or traffic [of alcohol], the hand of the legislature cannot be stayed from providing for its discontinuance, by any incidental inconvenience which individuals or corporations may suffer. All rights are held subject to the police power of the State.").

133 *See generally* Dubber *supra* note 109.

134 *See, e.g.*, State ex rel. Townsend v. Board of Park Comm'rs of Minneapolis, 110 N.W. 1121 (Minn. 1907); *see also* City of Shawnee v. Thompson, 275 P.2d 323, 324 (Okla. 1954) (holding that a "city cannot give away its rights in the public streets").

135 People v. Johnson, 129 Cal.App.2d 1, 7 (Cal.App. 4 Dist. 1955) ("Whenever a thing or act is of such a nature that it may become a nuisance, or may be injurious to the public health, if not suppressed or regulated, the legislative body may, in the exercise of its police powers, make and enforce ordinances to regulate or prohibit such act or thing, although it may never have been offensive or injurious in the past.") (internal citation omitted).

hibit noxious chemicals[136] and generally to decide matters of public policy and regulate in the public good.[137] On the other hand, enshrining special tax treatment via contract does not trigger police power concerns.[138] The government cannot simply invoke the police power to escape ordinary financial commitments.[139]

B. The Decline of the Contract Clause in the 20th Century

The Contract Clause fell into abeyance in the twentieth century.[140] Oliver Wendell Holmes had clarified that parties could not immunize themselves from sovereign power by simply contracting around it.[141] The legal realists in turn had effectively desanctified and "publicized" contract.[142] Scholars scruti-

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136 *See, e.g.*, *Fertilizing Co.*, 97 U.S. at 665.

137 *See, e.g.*, *Spannaus*, 438 U.S. at 241 ("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.").

138 *See, e.g.*, Mobile & Ohio R.R. v. Tennessee, 153 U.S. 486, 499–503 (1894) (upholding earlier grant of tax exemption against later legislative impairment); *see also Stone v. Mississippi*, 101 U.S. at 820 ("While taxation is in general necessary for the support of government, it is not part of the government itself. Government was not organized for the purposes of taxation, but taxation may be necessary for the purposes of government…[Government] for a consideration … may, in the exercise of a reasonable discretion, and for the public good, surrender a part of its powers in this particular."); Home of Friendless v. Rouse, 75 U.S. 430, 436–38 (1869) (earlier grant of tax exemption to charitable organization could not be superseded by later legislation); Ely, *supra* note 52 at 383 ("Despite the growth of the police power exception, courts in the late nineteenth century… continued to uphold grants of tax immunity under the Contract Clause.").

139 *United States Trust*, 431 U.S. at 24 ("If a state could reduce its financial obligations whenever it wanted to spend the money for what is regarded as an important public purpose, the Contract Clause would provide no protection at all.").

140 Ely, *supra* note 52, at 376 ("[N]otwithstanding . . . a host of nineteenth-century state and federal court decisions affirming the sanctity of contracts in the face of attempted state abridgement, the Contract Clause steadily declined in importance in the twentieth century."); *see also* Thomas W. Merrill, *Public Contracts, Private Contracts, and the Transformation of the Constitutional Order*, 37 CASE W. RES. L. REV. 597, 598 (1986) (observing the "demise" of the Contract Clause and noting that it had been enforced only twice in the post-New Deal court, once in *United Trust Co. v. New Jersey*, 431 U.S. 1 (1977) and *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978)); Cass R. Sunstein, *Lochner's Legacy*, 87 COLUM. L. REV. 873, 890–91 (1987) (noting that the Contract Clause was now "a dead letter" due in large part to expansive twentieth-century understandings of the police power).

141 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.").

142 *See, e.g.*, Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 604–06 (1943) (attacking "liberty of contract" and arguing that private contracts always presupposed public enforcement by the state); *see also* Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1030 (1985) (discussing the legal realists' deconstruction of classic contract doctrine).

nized the pervasive, state-sanctioned entrenchment of private power.[143] All of this in the era when, as Robert Hale noted, the Contract Clause began to be folded into general Due Process analysis.[144] A series of cases during and after the Great Depression yielded a jurisprudence of deference. *Home Building & Loan Association v. Blaisdell* is considered the most important of these.[145] The legislation at issue in *Blaisdell* was Minnesota's Mortgage Moratorium law, passed in the midst of the Great Depression to provide emergency relief to homeowners no longer able to pay their mortgages.[146] Citing the cases discussed above, and against a strenuous dissent, the *Blaisdell* Court held that creditors could not use the Contract Clause to block the mortgage moratorium legislation.[147] Although clearly legislation passed to remedy an emergent crisis, the court's holding was not so limited.[148] The Court noted that "the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula…Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power."[149]

After *Blaisdell*, the Court fashioned a jurisprudence of deference to general economic regulations, clarifying that police powers could trump contract even in the absence of emergency conditions.[150] Consider as an example

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143 *See generally* Louis L. Jaffee, *Law Making by Private Groups*, 51 HARV. L. REV. 201 (1937).

144 Robert L. Hale, *The Supreme Court and the Contract Clause: III*, 57 HARV. L. REV. 852, 890–91 (1944) ("It can be said, however, that there is at least a tendency for the contract clause and the due process clause to coalesce. Although there is no clause expressly forbidding the federal government to pass laws impairing the obligation of contracts, any federal law impairing them in a manner which the Supreme Court deemed unreasonable would doubtless be held to be a deprivation of property without due process, contrary to the Fifth Amendment."); *see also* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 241 (1978) ("Although it was perhaps the strongest single constitutional check on state legislation during our early years as a Nation, the Contract Clause receded into comparative desuetude with the adoption of the Fourteenth Amendment, and particularly with the development of the large body of jurisprudence under the Due Process Clause of that Amendment in modern constitutional history.").

145 290 U.S. 398 (1934); David A. Pepper, *Against Legalism: Rebutting an Anachronistic Account of 1937*, 82 MARQ. L. REV. 63, 145–46 (1998) ("In the regulatory and Contracts Clause realm, *Blaisdell* came to signify judicial deference to legislative power to interfere with contracts . . . ."); Ely, *supra* note 52, at 388 (finding that *Blaisdell* delivered a "near-fatal punch" to the Contract Clause).

146 *Blaisdell*, 290 U.S. at 416.

147 *Id.* at 435–40.

148 *Id.* at 426 ("While emergency does not create power, emergency may furnish the occasion for the exercise of power."); *see also* Energy Reserves Group, Inc. v. Kansas Power and Light Co., 459 U.S. 400, 412 (1983) ("[S]ince *Blaisdell*, the Court has indicated that the public purpose need not be addressed to an emergency or temporary situation.") (citing *United States Trust.*, 431 U.S. at 22, n.19)).

149 *Blaisdell*, 290 U.S. at 428; *Id.* at 439.

150 *See, e.g.*, West Coast Hotel v. Parrish, 300 U.S. 379 (1937) (upholding minimum wage law under Due Process Clause as a valid exercise of the police power); *see also* Bibb v. Navaho Freight Lines, 359 U.S. 520, 529 (1959) ("The various exercises by the States of their police pow-

Veix v. Sixth Ward Bldg. & Loan Ass'n, where plaintiffs had purchased shares in the Loan Association Network, a building and loan association.[151] At the time the shares were purchased, the relevant statutes created a framework for withdrawing shares.[152] In the early and mid-1930s, the relevant New Jersey legislation was amended, altering the procedure for withdrawing shares.[153] Plaintiff objected to these amendments under Contract Clause and Due Process theories.[154] This argument failed under *Blaidsell* and general police powers principles.[155] The Court gave a nod to *Blaidsell*'s "emergency temporary measure" rationale, but there is little cause to think that the decision would have come out differently without that fiction.[156] And if there were any lingering doubts that the police power exception did not depend on any emergency rationale, broad and expansive language in *N.Y. Sav. Bank v. Hahn* a few years later should have put those to rest. [157]

C. The Contemporary Approach

Justice Marshall's Contract Clause had essentially become a dead letter during the New Deal period.[158] Contract Clause cases, like economic legislation

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er stand, however, on an equal footing. All are entitled to the same presumption of validity when challenged under the Due Process Clause of the Fourteenth Amendment."); Rebecca M. Kahan, Comment, *Constitutional Stretch, Snap-Back, & Sag: Why* Blaisdell *Was a Harsher Blow to Liberty Than* Korematsu, 99 N.W. U. L. REV.1279, 1305 (2005) ("The Court further developed *Blaisdell* in a manner which emphasized and increased the power granted to governments *but without limitation to emergency situations*.").

151 310 U.S. 32 (1940).

152 *Id.* at 35.

153 *Id.*

154 *Id.* at 36.

155 *Id.* at 38–39.

156 *Id.* at 39–40.

157 326 U.S. 230, 234–35 (1945) ("The *Blaisdell* case and decisions rendered since… yield this governing constitutional principle: when a widely diffused public interest has become enmeshed in a network of multitudinous private arrangements, the authority of the State to safeguard the vital interests of its people….is not to be gainsaid by abstracting one such arrangement from its public context and treating it as though it were an isolated private contract constitutionally immune from impairment.") (citations omitted); *see also United States Trust*, 431 U.S. at 19 (clarifying that there is no "emergency" requirement for a valid exercise of police power against contract interests); W. B. Worthen Co. v. Thomas, 292 U.S. 426, 432–34 (1934) (police power principle applies both to emergency and routine exercises of sovereign power).

158 Thomas W. Merrill, *Public Contracts, Private Contracts, and the Transformation of the Constitutional Order*, 37 CASE W. RES. L. REV. 597, 598 (1986) ("Today, the contract clause is but a pale shadow of its former self. With two exceptions, the Supreme Court has rejected every contract clause contention that has come before it in the post-New Deal era. Although the Court has never formally equated contract clause analysis with the 'rationality review' it applies to economic legislation under the due process and equal protection clauses, the tone of recent contract clause decisions approaches this same degree of extreme deference.").

more generally, were largely being analyzed under a deferential rationality review.[159] The last major Contract Clause case before the late 1970s was *City of El Paso v. Simmons* in which the Supreme Court was called upon to decide the validity of a Texas state statute governing land forfeiture. The 1910 statute authorized the State Land Board to sell public lands and to collect interest from the purchaser.[160] In the event of a missed interest payment, the land would escheat to the state unless the owner could make the payment before the land was sold to a third party.[161] A 1941 amendment provided that the resale of the land would be permissive instead of mandatory and allowed a period of five years to reinstate missed interest payments.[162] Payments on a piece of land fell into arrears in the 1940s.[163] Plaintiff obtained the land through quitclaim deed and filed an application for reinstatement.[164] The applications were denied because they were not made within the five-year window allowed under the 1941 amendment.[165] Plaintiff lost at the district court because the claim was late under the 1941 statute.[166]

The Fifth Circuit reversed: the right to reinstate outside the five-year window had vested and as a result the Contract Clause prevented the government from retroactively depriving plaintiff of that vested right.[167] The Court reversed the Fifth Circuit under the reasoning of the *Blaidsell* cases and conducted a general public policy analysis to determine whether the 1941 statute was a reasonable exercise of Texas's police powers.[168] It was: the 1941 amendment was needed "to restore confidence in the stability and integrity of land titles and to enable the State to protect and administer its property in a business-like manner"[169] and to quiet the "spate of litigation" that had accompanied the "imbroglio over land titles" created by the earlier statute.[170] Moreover, the right to reinstate payment couldn't reasonably be considered as a material inducement to enter the original land contracts. Hence, abridging that statutory right was not abridging a contract right at all.[171]

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159 *See* Merrill, *supra* note 176.

160 379 U.S. 497, 498 (1965).

161 *Id.* at 498–99.

162 *Id.* at 499.

163 *Id.* at 500–01.

164 *Id.*

165 *Id.* at 501.

166 *Id.*

167 *Id.*

168 *Id.* at 509–14.

169 379 U.S. at 511.

170 *Id.* at 513.

171 *Id.* at 514.

1. A Contract Clause Revival?

This was the state of the law through the late 1970s. Beginning in the late 1970s, however, the Court seemed poised to revive the Contract Clause. Two Supreme Court cases upheld Contract Clause challenges for the first time in fifty years and articulated the modern framework for Contract Clause analysis. In the first of these cases, *United States Trust Co. v. New Jersey*, plaintiffs were bondholders in the New York and New Jersey Port Authority.[172] The 1962 bond agreement at issue had limited the Port Authority's power "to subsidize rail passenger transportation from revenues and reserves."[173] New York and New Jersey passed parallel statutes that voided the covenant in the 1962 agreement and bondholders sued.[174] The courts below ruled that the 1974 repeal was a valid and reasonable exercise of its police power.[175] The Supreme Court reversed and in so doing provided the most extensive discussion of the contract-sovereignty problem in thirty years. Justice Blackmun's majority opinion reiterates the basic story recounted above: the Contract Clause does not protect agreements in which the government had alienated some key aspect of its sovereignty.[176] But whether the police power is infringed depends on the nature of the contract term at issue.[177] Since the earliest cases, courts have invoked two distinct principles to justify the police power exception. On the one hand, as *Fletcher* teaches: "one legislature cannot abridge the powers of a succeeding legislature."[178] This is an anti-entrenchment principle.[179] On the other hand, as *Stone v. Mississippi* and later cases provided: "the legislature cannot bargain away the police power of a State."[180] This is the *void ab initio* logic discussed above.[181]

Although conceding that the distinction was "formalistic," the Court noted that financial or taxing functions had been exempted from the ambit of the police power exception.[182] The partial exemption for "financial obligation" represented by the Port Authority bond deal here is consonant with the precedent

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172 431 U.S. 1 (1977)

173 *Id.* at 3.

174 *Id.*

175 *Id.* at 3–4.

176 *Id.* at 21–24.

177 *Id.* at 23–24.

178 *Id.* at 23 (citing *Fletcher*, 10 U.S. at 135).

179 Christopher Serkin, *Public Entrenchment Through Private Law: Binding Local Governments*, 78 U. CHI. L. REV. 879 (2011).

180 *United States Trust*, 431 U.S. at 23 (Citing *Mississippi v. Stone* at 817).

181 *See supra* Section III; *see also* Serkin, supra note 210 at 924–25 ("courts striking down Contracts Clause challenges to government regulations interfering with pre-existing contracts did so on grounds that the original government did not have the power to enter into the contract in the first place").

182 *United States Trust*, 431 U.S. at 24–25.

established in the nineteenth century.[183] In short, taxation and debt contracts are different. None of this means that the government is always bound by prior financial obligations. Rather, the subsequent impairment survives Contract Clause scrutiny if "it is reasonable and necessary to serve an important public purpose."[184] This appears merely to be a restatement of the deferential "reasonableness" standard that had been the norm since the New Deal. Logically, however, financial contracts of the legislature present a special case cautioning against applying the same deferential standard. After all, if we allow the legislature to beg off paying its debts solely by shouting "police power," the Contract Clause would provide scant protections indeed.[185] But where do we draw the line? An earlier Supreme Court case, *W. B. Worthen Co. v. Kavanaugh*, had asked whether the government had "totally destroyed" the contract interest at issue.[186] The lower court relied on this notion to uphold the bond legislation because it had not totally destroyed the value of the bonds.[187] But the lower court had misread Justice Cardozo's opinion in *Worthen v. Kavanaugh*, which did not hold that anything less than a total destruction of the value of the contract made it permissible.[188] The line separating permissible from impermissible abridgement of the state's debt obligations could be marked at some point below total destruction of the value of the contract.[189] So the total destruction test wouldn't work. If the government wanted out of its earlier financial commitments to Port Authority bondholders, it would need to demonstrate that the impairment was "reasonable and necessary" to achieve a public purpose.[190] Thus the Court announces what is essentially a strict scrutiny standard for private-public contracts.[191]

Strict-scrutiny asks three questions: (1) whether a contractual relationship exists; (2) whether the change in the law impairs the contractual relation-

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183 *See also* Murray v. Charleston, 96 U.S. 432, 445 (1877) ("The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons…A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity.").

184 *United States Trust*, 431 U.S. at 25.

185 *United States Trust*, 431 U.S. at 26.

186 W. B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935).

187 *United States Trust*, 431 U.S. at 26.

188 *Id.* at 26–27.

189 *Id.* at 27.

190 *Id.* at 29.

191 *Id.* at 26 (deference to legislative determination of reasonableness is not appropriate where the state's self interest is at stake); *see also* Buffalo Teachers Fed'n v. Tobe, 464 F.3d 362, 369 (2d Cir. 2006) ("When a law impairs a private contract, substantial deference is accorded to the legislature's judgments as to the necessity and reasonableness of a particular measure. Public contracts are examined through a more discerning lens. When the state itself is a party to a contract, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the state's self-interest is at stake.") *Id.* (internal citations omitted).

ship; and (3) the impairment is substantial.[192] Usually, the first two steps are treated as given and the Court moves directly to the third.[193] If the impairment was substantial, the Court then examines the nature of the public policy purportedly advanced by the impairing legislation.[194] And even if the public interest at play is substantial, the legislation must still be narrowly tailored to lessen unnecessary contract impairment.[195] Here, there was no question that subsidizing rail transportation—as the states had covenanted not to do in 1962—was a legitimate public policy.[196] The problem was in the narrow tailoring prong. After all, states could have chosen "a less drastic modification" than reneging on its promise not to dip into Port Authority reserve funds to subsidize public transport.[197] They could have found the money to subsidize rail transport elsewhere. Also, it wasn't as if the need to subsidize public railways was a new or unforeseeable development in 1962.[198] Thus did the Supreme Court find a Contract Clause violation for the first time in fifty years and clarified that there is a bifurcated Contract Clause analysis: one for private and the other for public contracts.[199] Where there are private contracts there is rational basis deference.[200] Where we have public contracts, courts apply heightened scrutiny.[201]

The companion "revival" case was *Allied Structural Steel Co. v. Spannaus*.[202] The statute at issue was Minnesota's 1974 Private Pension Benefits Protection Act, which imposed broader pension obligations on employers

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192 *Spannaus*, 438 U.S. at 244.

193 *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992).

194 Energy Reserves, 495 U.S. at 411–12 ("If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem.").

195 *Spannaus*, 438 U.S. at 246.

196 *United States Trust*, 431 U.S. at 28 ("Mass transportation, energy conservation, and environmental protection are goals that are important and of legitimate public concern.").

197 *Id.* at 29–30.

198 *Id.* at 31–32.

199 *Id.* at 22–24.

200 *Id.*

201 *See, e.g.*, United States v. Winstar Corp., 518 U.S. 839, 876 (1996) (noting heightened scrutiny under *United States Trust* when states violate their own contracts); *see also* Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 505 (1987) (noting lower scrutiny where state impairs private contracts) (citing *Energy Reserves*, 459 U.S. at 413); Energy Reserves Grp. v. Kan. Power & Light Co., 459 U.S. 400, 412–13 (1983) (same); Exxon Corp. v. Eagerton, 462 U.S. 176, 192 n.13 (1983) (government contract implicates "special concerns"); *Spannaus*, 438 U.S. at 244 n.15 (government impairments of its own obligations "face[s] more stringent examination under the Contract Clause than would laws regulating contractual relationships between private parties.") Michael W. McConnell has called heightened scrutiny for government contracts "precisely backwards." *Contract Rights and Property Rights: A Case Study in the Relationship Between Individual Liberties and Constitutional Structure*, 76 CALIF. L. REV. 267, 293–94 (1988).

202 438 U.S. 234 (1978).

than they had undertaken under earlier law.[203] It is important to note that this is a case about contract between private parties. Thus, here there is no *void ab initio* problem as there is when a legislature attempts to bargain away its police power to a contract counterparty. Nevertheless, the Contract Clause, of course, also limits retroactive impairment of private contracts.[204] The question here is whether the impairment of the earlier contract is "severe," which in this case it was, because the 1974 pension law retroactively "nullifie[d] express terms of the company's contractual obligations and impose[d] a completely unexpected liability in potentially disabling amounts."[205] Unlike the legislation upheld in *Blaidsell*, the Minnesota law imposed a "sudden, totally unanticipated, and substantial retroactive obligation" on private employers and was not passed in the shadow of "emergency conditions" as in *Blaidsell*.[206] The Court also held, on fairly anemic reasoning, that because the legislature was prompted to pass the law in response to a single large auto plant closure, it wasn't the same kind of "broad, generalized economic or social problem" that had licensed the police power exception in the *Blaidsell* cases.[207]

2. Life after *U.S. Trust* and *Spannaus*

Despite the hopes of some scholars,[208] the law did not revert to the Marshall Court's understanding of the Contract Clause. Instead, legislation that im-

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203 *Id.* at 238–39.

204 *Id.* at 244 (Contract Clause limits exercises of police powers that "effect[] substantial modifications of private contracts.").

205 *Id.* at 247.

206 *Id.* at 249.

207 *Id.* at 250. I find it difficult to see how a legislature responding to deindustrialization via pension legislation is not responding to a large social problem. *See id.* at 263 ("The Act is an attempt to remedy a serious social problem: the utter frustration of an employee's expectations that can occur when he is terminated because his employer closes down his place of work.") (Brennan, J., dissenting).

208 *See, e.g.*, Richard E. Levy, *Escaping* Lochner*'s Shadow: Toward a Coherent Jurisprudence of Economic Rights*, 73 N.C. L. REV. 329, 334–35 (1995) (citing *Spannaus* and *United States Trust* as signs of "renewed interest in economic rights" and the Contract Clause that the Supreme Court "cursorily rejected" soon thereafter); *see also* Barton H. Thompson, Jr., *The History of the Judicial Impairment "Doctrine" and Its Lessons for the Contract Clause*, 44 STAN. L. REV. 1373, 1374 (1992) (noting a small uptick in lower court enforcement of the Contract Clause but also pointing out that the Supreme Court had not invalidated legislation under the Contract Clause since *United States Trust* and *Spannaus*); Douglas W. Kmiec & John O. McGinnis, *The Contract Clause: A Return to the Original Understanding*, 14 HASTINGS CONST. L.Q. 525, 545–46 (1987) (praising *Spannaus* and *United States Trust* for reviving the Contract Clause, but lamenting that the revival "falls far short of restoring it to the power is should enjoy, given the original intention of the Framers"); Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 703–04 (1984) ("The occasional Supreme Court decision hints at renewed judicial enforcement of limitations on the legislative regulation of economic activities, but these traces fade as quickly and quietly as they appear") (citing *Spannaus*, 438 U.S. at 240–51). It should be noted that states constitutions usually contain their own contract clauses. *See* Brian A. Schar,

pairs private-private contracts will be reviewed under the deferential rational basis standard.[209] We ask whether the impairment is a reasonable means to a legitimate public purpose.[210] Where, on the other hand, the government is a counterparty, there is a more searching inquiry.[211] At this point, courts will engage in a three-part analysis: whether there is a contract, whether the change in law impairs the contract and whether the impairment is substantial.[212] If the impairment is not substantial, the inquiry ends: only substantial impairments are entitled to Contract Clause protection.[213] To determine "substantiality," we examine "the extent to which the [parties'] reasonable contract expectations have been disrupted;"[214] whether "the industry the complaining party has entered has been regulated in the past;"[215] whether the future regulation was foreseeable when the contract was made.[216] If the impairment is deemed "substantial," it can only survive if it is "reasonable and necessary to serve an important public purpose."[217] Where the impairment is substantial, the legislation must protect "broad societal interest rather than a narrow class."[218] The state bears the burden of demonstrating a legitimate public purpose.[219] A legitimate public purpose is one "aimed at remedying an important general social or economic problem rather than providing a benefit to special interests."[220]

Note, *Contract Clause Law under State Constitutions: A Model for Heightened Scrutiny*, 1 TEX. REV. L. & POL. 123, 125 (1997) ("Most state constitutions protect contracts from impairment independently from the United States Constitution.").

209 *See, e.g.*, *Ass'n of Surrogates and Supreme Court Reporters Within City of New York v. State of N.Y*, 940 F.2d 766, 771–72 (2d Cir. 1991) ("Generally, legislation which impairs the obligations of *private* contracts is tested under the contract clause by reference to a rational-basis test; that is, whether the legislation is a 'reasonable' means to a 'legitimate public purpose.")

210 *Id.*

211 *Id.* at 771.

212 RUI One Corp. v. City of Berkeley, 371 F.3d 1137, 1147 (9th Cir. 2004); *see also* Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411 (1983). The three-part test has also been stated this way "(1) is the contractual impairment substantial and, if so, (2) does the law serve a legitimate public purpose such as remedying a general social or economic problem and, if such purpose is demonstrated, (3) are the means chosen to accomplish this purpose reasonable and necessary." Buffalo Teachers Fed'n v. Tobe, 464 F.3d 362, 368 (2d Cir. 2006).

213 *Spannaus*, 438 U.S.at 245; *see also* General Motors Corp. v. Romein, 503 U.S. 181, 186 (1992).

214 *In re: Workers' Compensation Refund*, 46 F.3d 813, 819 (8th Cir.1995).

215 *Energy Reserves*, 459 U.S. at 411.

216 *United States Trust*, 431 U.S. at 31–32 (upholding Contract Clause in part because the need for mass transit was well known at the time the states entered the Port Authority bond agreements).

217 *Id.* at 25.

218 *Spannaus*, 438 U.S at 249.

219 White Motor Corp. v. Malone, 599 F.2d 283, 287 (8th Cir.1979) (holding that the burden is on the state to justify the impairment and bears a heavier burden of justification where the impairment is substantial).

220 *Energy Reserves*, 459 U.S. at 412.

Recent case law has developed the principles laid down in *US Trust* and *Spannaus*.[221] As it has always been, Contract Clause analysis today is highly fact specific.[222] The impairing legislation must "protect a broad social interest."[223] Where the state is targeting vulnerable groups or rewarding favored parties, the court will not find a "public interest."[224] Eliminating windfall profits, on the other hand, is a legitimate public interest.[225] If the possible rescission of the government contract was foreseeable at the time it was made, courts are less likely to find an impermissible impairment. So, for example, where an industry is heavily regulated, it is not reasonable to think that there will be no future regulatory changes that impair the value of contracts.[226] An impairment is not "necessary" where there is "an evident and more moderate course of action that would serve Defendants' purposes equally well."[227] The state bears the bur-

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221 For recent discussions of the Contract Clause, *see, e.g.*, Evan C. Zoldan, The Permanent Seat of Government: An Unintended Consequence of Heightened Scrutiny under the Contract Clause, 14 N.Y.U. J. LEGIS. & PUB. POL'Y 163 (2011) (arguing that under the Contract Clause the 1846 retrocession of Alexandria to Virginia that led to a one-third decrease in the land area of the District of Columbia was invalid under the original grant); *see also Rachel Moroski, Desperate Times Don't Always Call for Desperate Measures: Professional Engineers v. Schwarzenegger Through the Lens of the Contract Clause*, 46 U.S.F. L. REV. 183 (2011) (arguing that furloughs imposed on state workers in violation of labor statutes violated Contract Clause); Alex McBride, *The Constitutionality of and Need for Mortgage Moratoria in the Context of Hurricane Katrina*, 81 TUL. L. REV. 1303, 1307 (2007) (Hurricane Katrina justified "drastic mortgage moratoria" under the Contract Clause); E. Glenn Thames, Jr., Comment, *The New Texas Anti-Deficiency Statutes: Do They Impair Contracts?*, 44 BAYLOR L. REV. 373, 384 (1992) (discussing Contract Clause challenge to Texas anti-deficiency statutes); Comment, *The Constitutionality of the New York Municipal Wage Freeze and Debt Moratorium: Resurrection of the Contract Clause*, 125 U.PA.L.REV. 167, 188–91 (1976).

222 Stephen F. Befort, *Unilateral Alteration of Public Sector Collective Bargaining Agreements and the Contract Clause*, 59 BUFF. L. REV. 1, 2 (2011).

223 *Spannaus*, 438 U.S. at 249–50.

224 *See, e.g.*, *Spannaus*, 438 U.S. at 247–49 (upholding Contract Clause where legislation targeted a narrow group of employers); *see also Energy Reserves*, 459 U.S. at 410 n.11 (one Contract Clause factor is whether the legislation is "one to protect a basic societal interest, rather than particular individuals."); *Energy Reserves*, 459 U.S. at 417 n.25 (present case different from *Spannaus* because that case involved "a small number . . . singled out from [a] larger group"); Mascio v. Public Employees Retirement System of Ohio, 160 F.3d 310, 314 n.2 (6th Cir. 1998) (Contract Clause enforced where Ohio statute had a narrow focus and was aimed at specific employers); Bd. of Comm'rs of the Orleans Levee Dist. v. Dep't of Natural Res., 496 So. 2d 281, 293 (La. 1986) (state not exercising police power where it is "providing a benefit to special interests").

225 *See Energy Reserves*, 459 U.S. at 412 (citing *United States Trust*, 431 U.S. at 31).

226 *See id.* at 411 ("[S]tate regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment.") (citing *United States Trust*, 431 U.S. at 26–27); *see also Energy Reserves* , 459 U.S. at 412 ("In determining the extent of the impairment, we are to consider whether the industry the complaining party has entered has been regulated in the past") (citing *Allied Structural Steel Co.*, 438 U.S. at 242, n.13).

227 Univ. of Haw. Prof'l Assembly v. Cayetano, 183 F.3d 1096, 1107 (9th Cir. 1999) ("An impairment may not be considered necessary if there is an evident and more moderate course of action that would serve Defendants' purposes equally well.") (citing *United States Trust*, 431 U.S.

den of showing that there were not more moderate alternatives.[228] If the impairment is "limited and temporary" it is more likely to be reasonable.[229] Where the state is trying to escape its financial obligations, courts will rarely if ever find that the retroactive alteration was "necessary."[230]

3. The *Winstar* Curveball

No overview of the Contract Clause would be complete without discussing *United States v. Winstar Corporation.*[231] Two initial caveats are in order. First, *Winstar* is not technically a Contract Clause case because it deals with the federal government, and the Contract Clause only applies to the states.[232] And, second, the *Winstar* Court was quite fragmented: Justice Souter wrote a plurality opinion, which was joined by Justice Stevens, Justice Breyer and partially by Justice O'Connor.[233] Justice Scalia concurred in the judgment and authored a separate opinion, joined by Justice Kennedy and Justice Thomas.[234] Justice Breyer also wrote a separate concurring opinion.[235]Justice Rehnquist wrote the dissent onto which Justice Ginsburg signed with reservations.[236] Nevertheless, *Winstar* helped shaped judicial understanding of public contracts and so is worth reviewing here briefly.[237]

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at 31); Garris v. Hanover Ins. Co., 630 F.2d 1001, 1010 (4th Cir. 1980) (statute rejected under Contract Clause because it served a "purely private" benefit).

228 *S. Cal. Gas Co. v. City of Santa Ana*, 336 F.3d 885, 897 (9th Cir. 2003); *see also Cayetano*, 183 F.3d at 1107 (enforcing Contract Clause in part because the government did not establish that it could not have chosen a path less onerous to plaintiff's contract interest).

229 *Spannaus*, 438 U.S. at 25; *Blaisdell*, 290 U.S. at 439–40 (upholding mortgage moratorium in part because it was "limited and temporary"); *Hanover Ins. Co*., 630 F.2d at 1010 (rejecting legislation because there was "[n]o limited period for unilateral terminations under existing contracts…. The impact of the legislation was thus immediate, irrevocable, and without limit of time, in binding the insurance company in a completely altered, economically disadvantageous relationship with every agent with whom it had an agency contract on the effective date of the legislation.").

230 S. Cal. Gas Co. v. City of Santa Ana, 336 F.3d 885, 897 (9th Cir. 2003) ("In the last thirty-five years, no Ninth Circuit or Supreme Court case has found a statute or ordinance necessary when the law in question altered a financial term of an agreement to which a state entity was a party."); *see also Cayetano*, 183 F.3d at 1107 ("If a state could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.") (citing *United States Trust*, 431 U.S. at 29).

231 518 U.S. 839 (1996).

232 *Id.* at 876.

233 *Id.* at 843; *see also Cuyahoga Metropolitan Housing Authority v. U.S.* 57 Fed.Cl. 751, 772 (Fed.Cl. 2003) (questioning the precedential effect of *Winstar*'s fragmented opinion).

234 *Id.* at 919.

235 *Id.* at 910.

236 *Id.* at 924.

237 State courts have continued to cite *Winstar*'s analysis of the Contract Clause, despite the fact that *Winstar* is not a Contract Clause case. *See, e.g.*, State ex rel. Humphrey v. Philip Morris,

During the savings-and-loan era of the 1980s, Congress afforded favorable accounting treatment to certain banks in exchange for their assumption of liabilities.[238] Then, in 1989, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which created stricter capital requirements than some of the banks could meet under the favorable accounting treatment they had been afforded prior to FIRREA.[239] The banks sued for breach of pre-FIRREA agreements to allow favorable accounting treatment.[240] The government defended on the grounds that it could not promise to refrain from exercising sovereign power in the future unless that promise was rendered in unmistakably clear language.[241] The government also argued that FIRREA was a sovereign act that could not trigger liability.[242] There were four defenses the government could raise in this situation: (1) surrenders of sovereignty must be unmistakable;[243] (2) an agent's authority to surrender sovereignty must also be unmistakable;[244] (3) that a government may not surrender reserved powers;[245] and (4) a government's sovereign acts cannot give rise to a breach of contract action.[246]

Initially, Justice Souter noted the tension between contract and sovereignty discussed above and distinguished the idea of sovereignty under the American Constitution from that of Parliamentary supremacy under the British system. [247] The groundwork for the unmistakability defense raised by the government was laid by Justice Marshall's *Fletcher* opinion and in the line of police powers cases discussed above.[248] The Court synthesizes two principles from the early cases. First, there are reserved or sovereign powers that may not may be bargained away.[249] We are familiar with this precept from *Stone v. Mississippi*.[250] A second line of cases yielded the principle that all public grants should be

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713 N.W.2d 350, 359–60 (Minn. 2006) (citing *Winstar*'s discussion of reserved powers and unmistakability doctrines); *see also* Dairyland Greyhound Park, Inc. v. Doyle, 719 N.W.2d 408 (Wis. 2006) (same).

238 *Id.* at 843.

239 *See id.* at 845–58.

240 *Id.* at 859.

241 *Id.*

242 *Winstar*, 518 U.S. at 859.

243 *Id.* (citing *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52 (1986)).

244 *Id.* (citing *Home Telephone & Telegraph Co. v. Los Angeles*, 211 U.S. 265 (1908)).

245 *Id.* (citing *Stone v. Mississippi*, 101 U.S. 814 (1880)).

246 *Id.* (citing *Horowitz v. United States*, 267 U.S. 458, 460 (1925)).

247 *Id.* at 872–73 (citing G. WOOD, CREATION OF THE AMERICAN REPUBLIC 1776–1787, pp. 268–71 (1969)).

248 *Id.* at 874–76.

249 *Id.* at 874.

250 *Id.* at 874 n.20 (citing *Stone v. Mississippi*, 101 U.S. 814 (1880)).

strictly construed.[251] At the beginning of the majority's historical account, Justice Souter acknowledges that there are two separate doctrines at issue, "reserved powers" and the canon of construction that all public grants are to be strictly construed.[252] Reserved powers expresses the principle that "certain substantive powers of sovereignty [cannot] be contracted away" (what I have been calling the *void ab initio* idea).[253] The strictly construed idea is that the state may legitimately make public grants, but when they do so it must be in clear and unmistakable terms.[254] By contrast, some powers cannot be bartered away *no matter how clear and unmistakable the contract language*.[255] If the government barters away a police power, then the contract at issue is actually not a contract at all. But Court here makes a curious move: it lumps these two lines of cases together, calling them the "early unmistakability cases."[256] The requirement of unmistakability "served the dual purposes of limiting contractual incursions on a State's sovereign powers and of avoiding difficult constitutional questions about the extent of state authority to limit the subsequent exercise of legislative power."[257] What follows is a long discussion that blurs state and federal cases and the important distinction between police powers and unmistakability.[258] In my view, this doctrinal blurring was a mistake.

In any event, according to the plurality, the *Winstar* contracts did not waive a sovereign power by promising not to regulate, they merely provided that the government would assume the risk of future regulatory impairments.[259] This was well within the scope of the government's authority.[260] There is a prac-

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[251] *Id.* at 874 (citing *Providence Bank v. Billings*, 4 Pet. 514 (1830) and *Charles River Bridge v. Warren Bridge*, 11 Pet. 420 (1837)).

[252] *Id.* at 874–75.

[253] *Id.* at 874 (citing *West River Bridge Co. v. Dix*, 6 How. 507 (1848)).

[254] *Id.* (citing Providence Bank v. Billings, 4 Pet. 514 (1830) and *Charles River Bridge v. Warren Bridge*, 11 Pet. 420 (1837)).

[255] Hermosa Beach Stop Oil Coalition v. City of Hermosa Beach 86 Cal.App. 4th 534, 565 fn.18 (Cal.App. 2 Dist. 2001) ("Whether or not a public contract contains language expressly reserving the government's right to exercise its police powers, the significance of the reserved powers doctrine is precisely that the government always retains the right to do so.").

[256] *Id.* at 874–75.

[257] *Winstar*, 518 U.S. at 875.

[258] *Id.* at 876–81.

[259] *Id.* at 883 (holding that government cannot "simply shift costs of legislation onto its contractual partners who are adversely affected by the change in the law, when the Government has assumed the risk of such change."); *see also id.* at 889 ("The answer to the Government's contention that the State cannot barter away certain elements of its sovereign power is that a contract to adjust the risk of subsequent legislative change does not strip the Government of its legislative sovereignty.").

[260] *Id.* at 890 ("There is no question . . . that the Bank Board and FSLIC had ample statutory authority to . . . promise to permit respondents to count supervisory goodwill and capital credits toward regulatory capital and to pay respondents' damages if that performance became impossible.").

tical rationale, too: if the government could raise an unmistakability defense in every routine breach of contract case, the commerce of government would grind to a halt.[261] Another problem with the government's theory is that it depends on drawing a line between the government-as-contractor and the government-as-regulator.[262] This distinction has never been an easy one to draw and in this case the regulatory and non-regulatory aspects of the FIRREA were "fused."[263] So here the question is what the motivated the legislation in question.[264] Evidence suggested that the motive was to escape the earlier financial commitment Congress had made to the banks.[265] Moreover, there isn't a sovereignty-contract problem here because such problems only arise where the government promises not to exercise a sovereign power.[266] Here, they have merely promised to pay money damages in the event that they do exercise a sovereign power they have promised not to.[267]

The Dissent highlights the problem with the plurality's remedies theory.[268] It essentially reduces the scope of the sovereignty exception to situations where plaintiffs ask for injunctive relief, or ask for a damages award that would effectively operate as an injunction.[269] Aside from the fact that a court can't properly determine damages until it determines liability—the uncertain grounds for which is the very problem at issue—it is unclear why plaintiffs would ever risk losing on sovereignty grounds when they could simply claim that the government assumed the risk of breach and from there proceed to damages.[270] Although Justice Rehnquist doesn't quite put it this way, in my view it makes little sense to concede that—as a matter of firm and fixed principle —the State cannot barter away its police powers and then in the next breath neutralize that princi-

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261 *Id.* at 883–85.

262 *Id.* at 893.

263 *Id.* at 894.

264 *Id.* at 898 ("The greater the Government's self-interest.. the more suspect becomes the claim that its private contracting partners ought to bear the financial burden of the Government's own improvidence, and where a substantial part of the impact of the Government's action rendering performance impossible falls on its own contractual obligations, the defense will be unavailable."); *see id.* at 900–04 (examining the legislative history to find that Congress expected FIRREA to release the government from financial obligations).

265 *Id.* at 902.

266 *Id.* at 881–82. ("The Government cannot make a binding contract that it will not exercise a sovereign power, but it can agree in a contract that if it does so, it will pay the other contracting party the amount by which its costs are increased by the Government's sovereign act") (quoting *Amino Bros. Co. v. United States*, 178 Ct.Cl. 515, 525 (1967)).

267 *Winstar*, 518 U.S. at 881–82.

268 *Id.* at 926 (Rehnquist, J., dissenting); *see also* Joshua Schwartz, *Liability for Sovereign Acts: Congruence and Exceptionalism in Government Contracts Law*, 64 GEO. WASH. L. REV. 633, 692–93 (1996) (arguing that it is unsound to base sovereignty analysis on whether parties ask for damages versus injunctive relief).

269 *Winstar*, 518 U.S. at 926 (Rehnquist, J., dissenting).

270 *Id.*

ple by awarding damages to the disappointed contractor in the event of breach. That may make sense in a true unmistakability case at the federal level, but makes little sense where the question is whether the state has impermissibly bargained away a police power. Justice Rehnquist makes a similar point about the two cases the plurality relies on: neither *Cherokee Nation* nor *Bowen* required that the requested damages amount to an injunction before they held that fulfilling the contract would amount to a waiver of sovereignty. Neither case "hinted that the unmistakability doctrines applied in their case because the damages remedy sought amount[ed] to an injunction."[271] In other words, limiting a remedies request to damages cannot in itself save a contract that has improperly bartered away a police power. Moreover, this line of reasoning makes sense only where the government is treated as another private party. The problem is that the cases have consistently referred to the dual nature of the sovereign as contractor and lawgiver.[272] As Justice Rehnquist phrases it: "by minimizing the role of lawgiver and expanding the role as private contractor, the principal opinion has thus casually, but improperly, reworked the sovereign acts doctrine."[273]

4. Two aspects of police power

It is important to distinguish two aspects of the police power that are often used interchangeably. In one of the most comprehensive historical overviews of the police powers/Contract Clause doctrine, Janice Griffith explains:

> The judicial doctrine that prohibits a municipality from bargaining away its police powers often is used interchangeably with the doctrine that bars one legislative body from improperly binding its successors. Both doctrines prohibit a municipality from relinquishing control over those powers or functions that are indispensable to governance. The first doctrine highlights the necessity that a local government retain its powers to promote the public health, safety, and welfare. The second emphasizes the need for each legislative body to make its own policy as changing conditions dictate. The doctrines justify a municipality's discretion to derogate from a contract that bargains away its police powers or prevents it from fulfilling its vital functions.[274]

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271 *Id.* at 928 (Rehnquist, J., dissenting).

272 *See, e.g.,* Deming v. United States, 1 Ct.Cl. 190, 191 (1865) ("The United States as a contractor are not responsible for the United States as a lawgiver.").

273 *Winstar*, 518 U.S. at 931.

274 Griffith, *supra* note 92 at 282–83.

These two aspects are best clarified if we think about two ways that ordinary contracts can go wrong: one at formation and the other at breach. A contract can fail at formation if the subject matter of the contract is illegal.[275] The legislature is only competent to enter otherwise legal contracts. This is the reason that courts sometimes speak of contracts that are *void ab initio* when they purport to "bargain away the police powers." Judith Welch Wegner has referred to this as the "initial incapacity rule."[276] A legislative contract that, for example, sells off to a private party the right to cast a legislative vote is not a contract at all, it is a pseudo contract. The legislature simply lacks the power to do this. Such an act marks the limits of the police power, rather than being an example of it. Thus there is no cognizable contract to impair. The second exercise of public power, and the one courts tend to focus on, is the state's abrogation of the original contract through subsequent legislation. The question here is whether the state may impair *an otherwise legal* contract entered into by an earlier legislature. Unfortunately, modern Contract Clause courts have confused—or downplayed[277] — these two distinct kinds of police power analysis.[278] *Winstar* typifies this confusion.[279]

To see the distinction, consider the following hypothetical. Imagine the State of Euphoria signs a contract agreeing that Acme, a political consulting firm, will have exclusive right to select candidates for public office, and to conduct and certify elections in the State of Euphoria for the next fifty years. Acme diligently meets its obligations for ten years. Then, the State of Euphoria enacts a law called "Take Back Elections," providing that only employees of the State of Euphoria may conduct and certify elections. Acme is not pleased with this and sues the State of Euphoria on the grounds that the Take Back Elections law violates the Contract Clause. This is a public contract, so we would apply strict scrutiny and the three-part test discussed above, which focuses on how substan-

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275 1 WILLISTON ON CONTRACTS § 3:3 (4th ed.) ("As a general rule, both the object for which a contract is formed and the consideration for which a promise is given must be lawful… A bargain that is in violation of law, or whose formation or performance aids or assists any party in violating the law, is typically declared void, and no recovery of any sort may be had on such a bargain."); *see also* Illinois State Bar Ass'n Mut. Ins. Co. v. Coregis Ins. Co., Ill., 821 N.E.2d 706, 713 (Ill.App. 1 Dist.,2004) ("For instance, if the subject matter of a contract is illegal, that contract is void *ab initio.* So too are contracts where one of the contracting parties exceeded its authority in entering into the pact.").

276 Wegner, *supra* note 69 at fn.31.

277 The Court in *United States Trust* briefly discusses the *void ab initio* idea, but dismisses it as formalistic and states that it didn't apply in any event because "[w]hatever the propriety of a State's binding itself to a future course of conduct in other contexts, the power to enter into effective financial contracts cannot be questioned." *Id.* at 23–24.

278 See Wegner supra note 69 at fn.31 ("It is unfortunately the case that at times courts and commentators blur analyses by citing cases broadly and by using the phrase 'reserved powers doctrine' to refer both to this rule of *initial incapacity* and to the principle that governments may continue to assert their police power prerogatives to justify actions in contravention of private or public contracts *at a later date*.").

279 *See infra* Section IV.C.3.

tial the impairment is.[280] Here there is no question that this is a substantial impairment: Acme still has forty years left on its consulting contract promising access to revenues that they will now not be able to enjoy. But does anyone think that we should uphold this contract because it meets the criteria laid out in *U.S. Trust*? The answer to that question has to be "no" because Euphoria lacked the power to enter the consulting contract in the first place. Hence, there is no "contract" to enforce and no grounds for Acme to raise a Contract Clause challenge. The Contract Clause is a shield that private parties can use to defend against impairment of contract expectations. By the same token, the police powers exception to the Contract Clause is also a sword that legislatures may use to escape illegal bargains entered by earlier legislatures.[281]

What about an ordinary commercial purchase contract? Here, imagine that Euphoria agrees to purchase cleaning chemicals for use in a government office. This contract does not bargain away the police power because it neither delegates policymaking responsibilities to a private party nor does it promise any private party that it will not exercise its police powers.[282] Thus, Euphoria's chemical contract is not *void ab initio* and does not offend the principle announced in *Stone v. Mississippi*. But what if the state later impairs this purchase contract, say by declaring the cleaning chemical to be hazardous and unsalable? In that case, I think there is an important distinction from the consulting contract, which effectively allowed a private party to control the outcome of a political process. In the consulting contract, we aren't concerned that the later legislature will disturb legitimate business interests and expectations because no legitimate expectations have been formed. Here, however, the situation is quite different. After all, we allow legislatures *some* power to tie the hands of later legislatures in that later legislatures are not free to treat an earlier routine purchase contract as void.

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280 *See infra* Section IV.C.1.

281 *See* Zigler, *supra* note 68, at 1462 ("[A]nalysis under the contract clause is limited to declaring the statute unconstitutional. The provision does not authorize the courts to award damages in lieu of requiring the state to adhere to the original terms of the contract"); *see also* Carter v. Greenhow, 114 U.S. 317, 322 (1885) (stating that "the only right secured" by the Contract Clause is "to have a judicial determination, declaring the nullity of the attempt to impair [the contract's] obligation").

282 This is one reason why ordinary financial contracts are treated differently. *See, e.g.*, *U.S. Trust*, 431 U.S. at 24 (Whatever the propriety of a State's binding itself to a future course of conduct in other contexts, the power to enter into effective financial contracts cannot be questioned. Any financial obligation could be regarded in theory as a relinquishment of the State's spending power, since money spent to repay debts is not available for other purposes….[T]he Court has regularly held that the States are bound by their debt contracts.").

IV. NON-COMPETE CLAUSES REQUIRE STATES TO BARTER AWAY THEIR POLICE POWERS

The remainder of the Article proceeds as follows. Section IV.A presents excerpts from a fictional concession contract to illustrate two possible police powers/Contract Clause issues that might arise under common non-compete terms in recent infrastructure contracts. The Euphoria Concession Contract below mirrors language in the Chicago Parking Meter Concession Contract, key sections of which are included in the Appendix. Section IV.B then asks whether Euphoria has attempted to barter away its police power by promising not to build competing infrastructure or maintaining or upgrading existing infrastructure. The Article concludes that there is are solid grounds for objecting to certain terms in the Euphoria Concession Contract on the grounds that Euphoria did not have the power to promise not to build competing infrastructure.

A. Euphoria Concession Contract

The Appendix to this Article includes sample language from some real-world privatization contracts.[283] But to make things simple and focus our inquiry, let's return to our fictional State of Euphoria. Like most states, Euphoria is having budgetary problems. Things have only gotten worse since the financial meltdown of 2008. And like most states, Euphoria's power to borrow money is capped under state law.[284] Euphoria's physical infrastructure is decaying. The near collapse of a tunnel linking a commuter suburb with a downtown business district drew national media attention to the sad state of Euphoria's public infrastructure. The tunnel has been repaired, but legislators worry that under its current taxing regime, it simply will not have the resources to maintain the tunnel in the future. In 2008, Acme, a consortium of international investors, approaches state senators with a proposal: Acme will pay Euphoria $2 billion for the right to collect tolls from the tunnel and stretch of road that connects the downtown with the suburban bedroom community (the Acme Road). The contract will last 75 years and, among many other terms, includes the following language:

> (1) Euphoria retains its police powers;
>
> (2) Euphoria retains right of entry to the Acme Road at any time;
>
> (3) Euphoria will not build any competing public transportation system within ten miles of the Acme Road;

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283 *See* Appendix, *infra*.

284 *See* Roin, *supra* note 24.

> (4) Euphoria will not repair or upgrade any road or tunnel within 3 miles of the Acme Road;
>
> (5) Any exercise of Euphoria's police powers with respect to the Acme Road or any exercise of Euphoria's right of entry onto the Acme Road will constitute a Compensation Event;
>
> (6) If Euphoria violates Clauses 3 or 4 by building, maintaining or upgrading competing infrastructure, this will constitute a Compensation Event;
>
> (7) Upon the occurrence of a Compensation Event, Euphoria will pay Acme damages measured by the loss of toll revenue for the period of the Compensation Event;
>
> (8) Upon the occurrence of a Compensation Event, Acme retains the right to terminate the contract and Euphoria will pay Acme a fair market value for the remainder of the contract term.

Legislators worry that some of the contract terms might violate Euphoria State Constitution Article I, Section 1, which states:

> **Section 1: Internal government and police.**
>
> The government of the United States is a government of enumerated powers, and all powers not delegated to it, nor inhibited to the states, are reserved to the states or to the people thereof. Among the powers so reserved to the states is the exclusive regulation of their own internal government and police; and it is the high and solemn duty of the several departments of government, created by this constitution, to guard and protect the people of this state from all encroachments upon the rights so reserved.[285]

Despite these worries, Acme and Euphoria sign the contract in 2008. With the exception of a public complaint at the 25% increase in tolls,[286] this arrangement functions smoothly for several years. Acme nets $30 million annually from the toll concession. In the intervening years, media figures and academics in Euphoria have conducted an extensive public debate over traffic congestion in the

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285 West Virginia Constitution Article 1-2.

286 Anderson, *supra* note 2 ("Private investors recoup their money by maximizing revenue — either making the infrastructure better to allow for more cars, for example, or by raising tolls. (Concession agreements dictate everything from toll increases to the amount of time dead animals can remain on the road before being cleared.)).

downtown corridor. Air pollution and other environmental concerns also figure prominently in these discussions. In 2012, a slate of reform candidates is elected to the Euphoria legislature on a platform of reforming the transportation system.

In their first year in office the reformers put forward an ambitious Redevelopment Plan that would create a light-rail commuter system connecting the suburbs to the downtown business district. One independent study finds that this light rail system would lead to a 50% reduction in automobile traffic from the suburbs to the downtown corridor. The Redevelopment Plan is enacted into law and Euphoria is about to break ground when Acme sues for an injunction to stop the Plan from moving forward. In addition, Acme sues for damages in lost toll revenues that will result from the light rail system. How should a court adjudicate this challenge?

B. Euphoria's Concession Contract and the Contract Clause

Acme has sued Euphoria to prevent its going forward with the Redevelopment Plan or, in the alternative, to seek compensation under the contract in the event the court denies an injunction. Acme argues that the Contract Clause prohibits Euphoria from interfering with its contract expectancy. Moreover, Acme argues that because this is a public contract, the court should apply strict scrutiny. The first question for a court is whether the disputed contract terms represent an improper attempt to barter away Euphoria's police powers.[287] The Supreme Court has noted that "in deciding whether a State's contract was invalid ab initio under the reserved-powers doctrine, earlier decisions relied on distinctions among the various powers of the State."[288] *U.S. Trust* teaches that the state is free to "contract away" the power to tax and spend.[289] The Court in *U.S. Trust* first decided that the original 1962 bonds were the kind of financial debt contract that the state is free to enter and thereby bind future legislatures to pay.[290] Courts will likewise in almost every case enforce municipal bond contracts.[291] This is in line with the historical pattern of exempting taxing and spending from the police power traceable to the early decisions.[292]

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[287] *U.S. Trust*, 431 U.S. at 21–25; *see also* City of Aurora v. Burns, 319 Ill. 84, 149 N.E. 784 (1925); State Public Utilities Commission v. City of Quincy, 290 Ill. 360, 125 N.E. 374 (1919); Littell v. City of Peoria, 374 Ill. 344, 29 N.E.2d 533 (1940); People ex rel. Moshier v. City of Springfield, 370 Ill. 541, 19 N.E.2d 598 (1939)

[288] *U.S. Trust*, 431 U.S. at 23.

[289] *Id.* at 28–29 ("[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.").

[290] *Id*. at 24–25.

[291] *Id.* at 27; *see also* Pierce County v. State, 148 P.3d 1002 (Wash. 2006) ("[I]t is well-settled that municipal bonds are contractual obligations protected by the contract clause.").

[292] *See* Ely, *supra* note 53 at 383.

Unfortunately, that bright-line rule—a rare bird in this complex area of the law[293]— will not help us sort out Euphoria's problematic infrastructure concession deal, which is not analogous to the financial, bond or debt contracts at issue in *U.S. Trust*. So we will need to delve into the police power cases for additional guidance. Given the breadth of the police power idea developed in the case law, a Euphoria court is likely to find that the state's contract with Acme is void *ab initio*.

1. General legislation is an exercise of police power

No clear line has been identified separating permissible public contracting practices—such as routine financial transactions[294]—from impermissible attempts to barter away the police power.[295] Perhaps none ever can be. However, there is no question that the police powers limitation on government contracting is alive and well.[296] Despite skeptical attacks on the police powers idea as a "formalistic" relic of the past,[297] courts continue to rely on the police power

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293 *See* Stone v. State of Mississippi, 101 U.S. at 818 ("Many attempts have been made in this court and elsewhere to define the police power, but never with entire success. It is always easier to determine whether a particular case comes within the general scope of the power, than to give an abstract definition of the power itself which will be in all respects accurate.").

294 *See, e.g., U.S. Trust*, 431 U.S. at 24:

> Whatever the propriety of a State's binding itself to a future course of conduct in other contexts, the power to enter into effective financial contracts cannot be questioned. Any financial obligation could be regarded in theory as a relinquishment of the State's spending power, since money spent to repay debts is not available for other purposes. Similarly, the taxing power may have to be exercised if debts are to be repaid. Notwithstanding these effects, the Court has regularly held that the States are bound by their debt contracts.

Id.

295 *See, e.g.*, Cuyahoga Metropolitan Housing Authority v. U.S., 57 Fed.Cl. 751 (Fed.Cl. 2003) ("In truth, the most unmistakable thing about the 'unmistakability doctrine' is the sheer number of unresolved questions it engenders.").

296 *See, e.g.*, Commonwealth Edison Co. v. Illinois Commerce Com'n, 924 N.E.2d 1065, 1089 (Ill.App. 2 Dist. 2009) ("Regulatory ratemaking does not implicate the contract clauses of the state and federal constitutions…and the ability to set rates remains within the police power of the State."); *see also* Hermosa Beach Stop Oil Coalition v. City of Hermosa Beach 86 Cal.App. 4th 534, 565 (Cal.App. 2 Dist. 2001) (upholding law that banned oil drilling in Hermosa Beach as an "exercise of traditional police powers."); Mendly v. County of Los Angeles, 23 Cal. App.4th 1193, 1210 (Cal.App. 2 Dist. 1994) ("The County had no authority to 'contract out' of the then existing law…However, just as the County could not avoid its then existing statutory obligations, it could not compromise or avoid any *future* statutory obligations under different laws. Such a result is tantamount to a contracting away of the police power of the state."); Anderson v. State, 435 N.W.2d 74, 81 (Minn.App. 1989) ("Even if there had been a contractual obligation to maintain the tax exclusion, the obligation would have been void *ab initio* under the Minnesota Constitution article X, § 1, which prohibits contracting away the state's power to tax.").

297 *See, e.g.*, Burch, *supra* note 127, at 265 ("The reserved powers doctrine is essentially an artifact of legal history.").

framing to resolve real-world disputes.[298] The cases state categorically that the Contract Clause does not trump the police powers of a state. As Janice Griffith has ably demonstrated, however, there is no easy way to distinguish governmental powers which may not be alienated from routine propriety functions in which the government is acting as an ordinary contractor.[299] Nevertheless, the cases reveal a two-stage inquiry: "the first inquiry is whether the contract prevents the state from exercising essential attributes of sovereignty in violation of the reserved powers doctrine. If the answer is no, courts apply a three-part test."[300] The threshold question is whether one of the contract terms is *void ab initio*.[301] This involves classifying the governmental power at issue to decide whether what the government promised to do (or not to do) falls within the category of "essential attributes of sovereignty."[302] If the legislature attempted to bargain away police powers, there is little sense in asking whether a later rescission of the earlier improper contract is a "substantial impairment," because in such a case there is no cognizable interest to impair. If, on the other hand, the legislature has not bargained a way an essential aspect of sovereignty, then the court should proceed to the three-part test announced in *U.S. Trust*.[303]

The earliest cases established the principle that police powers are quite broad[304] and despite the Contract Clause revival, that principle retains vitality today.[305] Modern state courts understand most general statutory enactments as

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298 *See infra* Section IV (discussing representative modern police powers decisions). *See also* Liberty Mut. Ins. Co. v. Whitehouse, 868 F. Supp. 425 (D.R.I. 1994); Board of Educ. of Unified School Dist. No. 443, Ford County v. Kansas State Bd. of Educ., 266 Kan. 75 (1998); South Union Tp. v. Com., 839 A.2d 1179 (Pa. Commw. Ct. 2003); Massachusetts Mun. Wholesale Elec. Co. v. State, 161 Vt. 346 (1994).

299 Griffith, *supra* note 92, at 345.

300 Griffith, *supra* note 92, at 345.

301 *Dairyland*, 719 N.W.2d at 481 ("A threshold question in any contracts clause analysis is whether a contract to which a state is a party surrenders an essential attribute of state sovereignty. Contracts that limit the exercise of a state's police power or eminent domain power are invalid ab initio under the reserved-powers doctrine.") (internal citations omitted).

302 *U.S. Trust*, 431 U.S. at 25–26.

303 *See, e.g.*, Wisconsin Professional Police Ass'n, Inc. v. Lightbourn, 627 N.W.2d 512, 594–95 (Wis. 2001) ("If the legislative contract is not invalid *ab initio* under the reserved powers doctrine . . . the question becomes whether the legislature's impairment of the contract is reasonable and necessary to serve an important public purpose.") (citing *U.S. Trust*, 431 U.S. at 25).

304 *See, e.g.*, Stone v. Mississippi, 101 U.S. at 818 (regulating lotteries within the police power); *see also* Atlantic Coast Line R. Co. v. City of Goldboro, 232 U.S. 548, 558–59 (1914) (police power to "secure the health, safety, good order, comfort, or general welfare of the community" cannot be bargained away and does not require compensation when enforced.); Manigault v. Springs, 199 U.S. 473 (1905) (reclamation of swamp land upheld as a valid exercise of police powers).

305 *See e.g.*, Eberth v. Carlson, 971 P.2d 1182, 1187 (Kan. 1999) ("This court has recognized a city's right to regulate and restrict the use of public roads through its police power to the extent necessary to provide for and promote the safety, peace, health, morals and general welfare of the people.); *see also* Gordon v. Nash, 9 Alaska 701, 707 (D.Alaska Terr. 1940) ("Subject to constitutional limitations, the state has absolute control of its public streets and highways, including those

exercises of the police power.[306] For example, in *Hermosa Beach Stop Oil Coalition*, the city had agreed via contract that a party could drill for oil on city property, an agreement that was rescinded by Proposition E several years later.[307] The court held that Proposition E's ban on oil drilling was an exercise of traditional police powers.[308] Similarly, *Optimer Intern. v. RP Bellevue* upheld the Washington state Arbitration Act as a valid exercise of police power against a challenge by a commercial lessor. [309] *Okfuskee County Rural Water Dist. No. 3 v. City of Okemah* held that an Oklahoma city did not violate the Contract Clause by raising water rates because public contracts are always subject to later exercises of police power.[310] And *Sporales v. Binford* upheld as a valid exercise of police power Texas statutes imposing size and weight restrictions for vehicles against a challenge by transportation industry interests.[311] In these cases, broad, regulatory laws are classified as police powers. Contracts in which the government contracts away regulatory responsibilities, promises to regulate or to forgo regulation are typically held to be improper attempts to alienate the police power.[312]

The power to control, repair and otherwise maintain the public streets and roads is another example of the police power. State *ex rel.* Townsend v. Board of Park Comm'rs of Minneapolis presents this in clear terms:

> It is elementary and fundamental that the power to lay out, open, widen, extend, vacate, or abandon public highways, public parks, parkways, or boulevards is legislative, pure and sim-

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of its municipal and quasi-municipal corporations…This power to control public streets and to provide for proper adjustment of conflicting rights and interests therein is a police power.").

306 *See, e.g.*, Okfuskee County Rural Water Dist. No. 3 v. City of Okemah, 257 P.3d 1011, 1017 (Okla.Civ.App. Div. 3 2011) ("The United States Supreme Court has held that in the exercise of its police power, a state is limited only to the extent that it may not pass legislation which repudiates debts, destroys contracts, or denies the means to enforce contractual rights") (citing *City of El Paso*, 379 U.S. at 509).

307 *Hermosa Beach*, 86 Cal.App. 4th at 540.

308 *Hermosa Beach*, 86 Cal.App. 4th at 565.

309 214 P.3d 954, 968 (Wash.App. Div. 1 2009).

310 257 P.3d 1011, 1017 (Okla.Civ.App. Div. 3 2011) ("We find as a matter of law that the statute is an expression of the State's police power, it serves a legitimate public purpose, and does not destroy or even substantially impair the parties' contractual rights.").

311 286 U.S. 374, 388–89 (1932).

312 *See, e.g.*, City of Parsons v. Perryville Util. Dist., 594 S.W.2d 401, 407 (Tenn. Ct. App. 1979) ("the City had no power to bind itself to a rate for forty-five years which was not subject to increase to reflect the costs of increased capitalization of the system45 year water utility contract."); *see also* Fidelity Land & Trust Co. v. City of W. University Place, 496 S.W.2d 116, 118 (Tex. Civ. App. 1973) ("[W]e do not believe that it was within the contemplation of the Legislature that the city could bind itself in such a way as to effectively lose control over the operation of its sewer system…To uphold this agreement would be tantamount to allowing a private individual to inhibit the necessary exercise of discretion by the municipality over a governmental function. We hold that the agreement is not enforceable.").

> ple, to be exercised by the Legislature itself, or by municipal boards to which it may be delegated. It is also elementary that a municipality, acting through its legislative body, has no power to enter into contracts which curtail or prohibit an exercise of its legislative or administrative authority over streets, highways, or public grounds, whenever the public good demands that it should act.[313]

Townshend is a good example of an important line of cases couched in terms of a municipality acting *ultra vires* with respect to police powers conferred upon it by the state government. The theory in the municipal cases is that the police of the state has been delegated to the city and cannot be contracted away.[314] *Rockingham Square Shopping Center, Inc. v. Town of Madison* is another good example of this.[315] In *Rockingham*, the town promised that it would open a road as an inducement to a private developer to build a shopping center. The city had acted *ultra vires* in contracting away statutorily granted police powers.[316] In the municipal and zoning cases, courts typically hold that the government can alter zoning regulations even where it had promised it would not, or where doing so would impair contract obligations.[317] Despite being cast in *ultra vires* terms, these municipal cases demonstrate that the police power at issue is the same as that of the state in general.[318]

Cases arise where the state, city or county promise not to regulate in a certain way. These cases are decided on police powers theory, but often not with reference to the Contract Clause, but rather to state constitutional or statutory sources that instantiate the police power. Courts typically hold that the government has attempted to contract away a police power when it promises to regu-

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313 110 N.W. 1121, 1122–23 (1907).

314 *See, e.g.*, Bildingmeyer v. City of Deer Lodge, 274 P.2d 821, 823 (Mont. 1954) ("A municipality, in exercising the police power granted to it by the legislature, acts as the agent of the state…") (quoting 37 Am.Jur., Municipal Corporations, § 279, p. 907).

315 262 S.E.2d 705 (1980).

316 262 S.E.2d at 707–08; *see also* Levy Court v. City of Dover, 333 A.2d 161, 162–63 (Del. 1975) ("The power . . . to furnish water and sewer services in the County includes the power and the duty to decide if and when those services are required in the public interest; it does not include the power to surrender to others the responsibility for making those decisions.").

317 *See, e.g.*, Town of Pinebluff v. Marts Richeson v. Helal, 158 Cal.App. 4th 268 (Cal.App. 2 Dist. 2007) (city's changing of zoning rules in contravention of earlier agreement was an exercise of police powers); Utility Serv. Partners v. Pub. Util. Comm. 921 N.E.2d 1038, 1047 (Ohio 2009) (public utility commission acting within police powers when it ruled that public utility would assume obligations to repair gas lines that had been contracted out to private party).

318 *See, e.g.*, *Cotta v. City and County of San Francisco*, 157 Cal. App. 4th 1550, 1554 (Cal.App. 1 Dist. 2007) (defining "police power" as the "constitutional authority of counties or cities to adopt local ordinances [which is the] power of sovereignty or power to govern-the inherent reserved power of the state to subject individual rights to reasonable regulation for the general welfare. The police power extends to legislative objectives in furtherance of public peace, safety, morals, health and welfare.").

late or not regulate in a certain way in the future. For example, in *County Mobilehome Positive Action Committee, Inc. v. County of San Diego*,[319] the county agreed with some landowners to a fifteen-year moratorium on enacting rent-control legislation.[320] This was struck down as an attempt to barter away the police powers. The logic here is clear:

> It is to be presumed that parties contract in contemplation of the inherent right of the state to exercise unhampered the police power that the sovereign always reserves to itself for the protection of peace, safety, health and morals. Its effect cannot be nullified in advance by making contracts inconsistent with its enforcement . . . .[321]

Rent control statutes are broad, general regulatory measures that fall within the scope of police and the state cannot promise that it will not enact such measures in the future.[322] In a similar case, cited by the *Mobilehome* court, *Alameda County Land Use Assn. v. City of Hayward*[323] a memorandum of understanding between city and county respecting a 13,000 acre tract of land, agreed that each party would not take a certain course of action unless the other party did the same—essentially agreeing not to regulate in a certain way in the future.[324] This was an improper attempt to give up police powers: "This policy divests each respondent, presently and in the future, of its sole and independent authority to amend its respective general plan, by providing outside jurisdictions a veto over such amendments."[325] Likewise, between 2001 and 2003, the City and County of San Francisco passed a series of resolutions granting benefits to clean-air taxis, which they later reduced.[326] The later reduction was a valid exercise of the police power.[327]

2. The Euphoria contract promises not to regulate in the public good

It is worth noting at the outset that Euphoria's state constitution contains an explicit police power reservation clause.[328] But police powers exist whether

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319 62 Cal.App.4th 727 (Cal.App. 4 Dist. 1998).

320 *County Mobilehome*, 62 Cal.App.4th at 730.

321 *Id.* at 736.

322 *Id.* at 737.

323 38 Cal.App.4th 1716 (1995).

324 *Alameda County*, 38 Cal.App.4th at 754.

325 *Id.* at 757.

326 *Cotta v. City and County of San Francisco*, 157 Cal. App. 4th at 1553.

327 *Id.*

328 *See supra* Section IV.A.

they are specifically provided in the state constitution or not. Our first real challenge is to classify what exactly Euphoria promised to do or not to do in the Concession Contract. If Euphoria had granted favorable tax treatment, its later attempt to rescind that would be barred by *Winstar*.[329] Likewise, reneging on a financial contract would be impermissible under *U.S. Trust*.[330] The litigated terms here, by contrast, promise that Euphoria will refrain from undertaking certain policies in the future: in particular, policies of developing, maintaining or upgrading infrastructure that would compromise Acme's revenues under the agreement. The case law discussed in Section IV.B.1 *supra* point us to a single conclusion: Euphoria's promise not to build or improve roads is essentially a promise not to exercise classic police powers. It was a promise that Euphoria did not have the power to make. Hence, the non-compete clause is void *ab initio* and is unenforceable.

3. Police powers are not trumped by eminent domain

Before I leave the police power issue and turn to strict scrutiny under the Contract Clause, I must explain a pair of California cases that would seem to qualify my present argument. In *Professional Engineers v. Department of Transportation*, Caltrans contracted with a private company for the operation of a toll road.[331] The contract included a clause that read: "Caltrans agrees not to issue any competing franchise or open or operate any competitive transportation facility within the special zone for the term of the lease or agreement."[332] In a cursory opinion, the California appeals court, citing scant authority, held that this provision did not violate the police power. This was based on the conclusory ground that the state could later exercise its right of eminent domain if a police power conflicted with the non-compete provision.[333] In essence, the power to invoke eminent domain should allay our concerns about alienating the police power.

The *Professional Engineers* decision caused some mischief in a more recent case: *City of Corona v. State of Calif. Dept. of Trans.*, another round of litigation involving Caltrans and private toll roads.[334] The City of Corona pled damages flowing from "artificially elevated traffic congestion on State Highway 91," which they attributed to a non-compete clause in the toll concession contract that read: "Caltrans would not add new public lanes to the highway without

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329 *Winstar*, 518 U.S. at 875–76.

330 *U.S. Trust*, 431 U.S. at 24–25.

331 *Professional Engineers*, 13 Cal.App.4th at 590.

332 *Id.* at 591.

333 *Id.* at 591–92. ("[W]ere a legitimate, compelling public need to arise for a transportation facility within a franchise zone that would compete with one of the demonstration projects, the Legislature, acting to attain this public welfare object, could use its power of eminent domain to condemn the franchise.")

334 2003 WL 22332968 (Cal.App. 4 Dist.)

the agreement of the private toll road operators."[335] Facing an uphill climb because of the *Professional Engineers* precedent, the City argued inverse condemnation, which was unavailing.[336] The Corona court specifically cited *Professional Engineers*' holding that the non-compete wasn't a police powers problem because the state still retained the right to eminent domain.[337]

This is plainly not the law and never has been. One salient difference between eminent domain and police powers is that the exercise of the latter does not generally give rise to a compensation claim.[338] This principle is not absolute, of course. The government cannot escape a compensation claim merely by invoking police powers. In an era of regulatory takings, however, police powers and eminent domain can be located on a continuum.[339] In my view, the *Professional Engineers*' court simply reasons in a circle. After all, eminent domain is only available where there is property to be taken. The contractor does not own the road, so this is not a classic eminent domain issue. Rather, the "property" that would be taken in an infrastructure leasing case would be the contractor's interest in the lease.[340] But what is the contractor's interest in a lease that the legislature did not have the power to make? Invoking eminent domain to overcome a police powers objection simply *assumes* that the earlier grant created a vested property interest. Of course, whether a valid contract interest accrues in

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335 *Id*. at *1.

336 *Id*. *10–11.

337 *Id*.

338 E. FREUND, THE POLICE POWER, 546–47 (1904). ("[I]t may be said that the state takes property by eminent domain because it is useful to the public, and under the police power because it is harmful. . . . From this results the difference between the power of eminent domain and the police power, that the former recognizes. a right to compensation, while the latter on principle does not."); *see also* Machipongo Land and Coal Co., Inc. v. Com., Dept. of Environmental Resources, 676 A.2d 199 (1996); Appeal of White, 134 A. 409, 411 (Pa. 1926) ("Under eminent domain, compensation is given for property taken, injured, or destroyed, but under the police power, no payment is made for a diminution in use even though it amounts to an actual taking or destruction of property."); Thomas Merrill, *supra* note 131, at 426; Thomas supra note___ at 544 ("By constitutional law, a governmental entity may "take[]" private property if the taking is for a "public use" and is accompanied by "just compensation." By comparison, modern jurisprudence authorizes police power land use regulations that preserve or protect the public health, safety, morals, or welfare; imposing those regulations does not presume a requirement of compensation.")

339 David B. Fawcett, *Eminent Domain, the Police Power and the Fifth Amendment: Defining the Domain of the Takings Analysis*, 47 U. PITT. L. REV. 491 (1986); *see also Fair Compensation and the Accommodation Power: Antidotes for the Taking Impasse in Land Use Controversies*, 75 COLUM. L. REV. 1021, 1033-37 (1975); Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 508 (1987); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 425 (1982) ("The Court of Appeals determined that [the act] ... is within the State's police power. We have no reason to question that determination. It is a separate question, however, whether an otherwise valid regulation so frustrates property rights that compensation must be paid.")

340 Christopher Serkin, *Condemning the Decisions of the Past: Eminent Domain and Democratic Accountability*, 38 FORDHAM URB. L.J. 1175, 1181 (2011) ("In addition to the power to take real property, eminent domain applies to vested development rights, contract rights, and also more esoteric future interests in property.").

the first place is the very point at issue. Thus, invoking the availability of eminent domain as a trump to police powers is begging the question.

If you think about it for a moment, you can see why *Professional Engineer*'s reasoning creates a serious problem within the framework of existing legal doctrine. In every case finding an improper bartering away of the police power, the court could simply have ordered damages to the disappointed party under an eminent domain theory. Consider the classic police power cases. In *Stone v. Mississippi* the promise not to regulate the lottery was void, and hence not compensable, under the police powers theory, but the court could just as well have required compensation under an eminent domain theory.[341] But *Stone v. Mississippi* did not require compensation precisely because it had held that the legislature lacked the initial capacity to promise not to exercise its police powers in the future.[342] It was no rebuttal to say that the earlier promise became valid because it could later be violated and compensation paid. But this is how *Stone v. Mississippi* would have come out under the *Professional Engineers* logic: the *Stone* Court could simply have reasoned that the initial contract granting the lottery franchise was valid because the state could always exercise its power of eminent domain later. Such a ruling would eviscerate police powers as traditionally understood.

4. Contract Clause Strict Scrutiny

It is likely a Euphorian court, following the well-established precedent outlined above, would find the government's promise not to regulate in the future to be *void ab initio*. Assume for the sake of argument, however, that the court does not classify the non-compete clauses as invalid attempts to barter away the police power. Where, as here, the government is trying to get out of its own contract obligation, a court would apply the strict scrutiny approach and ask whether the Redevelopment Plan was a substantial impairment of the Acme Concession Contract. It is hard to argue that the Redevelopment Plan would not substantially impair the value of the Acme Concession Contract. Were Euphoria to go ahead with the project under its police powers, it would deprive Acme of 50% of the promised revenue because toll traffic would be siphoned off to the competing transport system. Another substantiality factor, whether the industry has been regulated in the past, is also satisfied in the case of public infrastructure, a highly regulated area.[343] Under *U.S. Trust* and *Spannaus*, the Redevelopment Plan would probably qualify as "substantial."[344]

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341 101 U.S. at 818–19.

342 *Id.*

343 *See, e.g., Energy Reserves*, 495 U.S. at 411.

344 *U.S. Trust*, 431 U.S. at 28 (impairment of the bonds substantial because it did not benefit the shareholders); *Spannaus*, 438 U.S. at 246 (impairment substantial where it retroactively altered company's pre-existing obligations under pension plan.)

The second phase of the analysis asks whether the impairing legislation furthers "a significant and legitimate public purpose such as the remedying of a broad and general social or economic problem."[345] Most of the factors in our Euphoria hypothetical would suggest that "yes" is a likely answer to this question. For one thing, the infrastructure contracts are not the routine financial contracts that courts rarely allow states to escape.[346] For another, the Redevelopment Plan is aimed at relieving traffic congestion and encouraging the use of public transportation. These aims look like classic expressions of public-regarding legislation as outlined in the discussion of police power cases in Section IV.C *supra*. But this is still a closer question than the police power inquiry. Recall that the Supreme Court rejected similar rationales for New York and New Jersey to back out their bond contracts in *U.S. Trust*.[347] Also, on our hypothetical, the legislation would seem to be aimed at one particular company, Acme. Where legislation seems to be targeted in this way, courts remain alert to possible special interest legislation that is presumptively not in the broad public interest.[348]

V. CONCLUSION

My goal in this paper has been to suggest lines of research and inquiry into the legal aspects of infrastructure privatization. It has been a thought experiment intended to shed light on a serious emerging policy issue whose implications have yet to be fully appreciated. The privatization of public infrastructure in the United States seems like a long-term trend. Critics are right to worry about the potential for abuse and the serious political and social costs of infrastructure privatization.[349] Given the negative publicity surrounding the non-competes and the terms of the privatization deals more generally, it is not surprising that several states already forbid non-compete clauses in their enabling statutes.[350] Recent academic work in this area has much to recommend it. But there is much work to be done. Much of the policy discourse has a curiously ahistorical quality to it, as if we were encountering the infrastructure privatization issue for the first time. It is thus quite important—even critical—to continue to develop and refine our historical and legal framework for privatization policy. As the discussion here has shown, American courts have been grappling with

345 *See, e.g., Energy Reserves*, 495 U.S. at 411–12.

346 *Id.* at fn.14.

347 *U.S. Trust*, 431 U.S. at 28.

348 *Id.*

349 *See supra* Section I.

350 *See* Pagano *supra* note 3 at 383 ("After its sour experience with SR-91, California amended its legislation to ban noncompetition clauses. The federal government also bans noncompetition clauses in leases affecting the Interstate Highway System. Texas, in its 2007 amendments, also banned noncompetition clauses.").

the proper legal architecture for public-private partnerships since the earliest days. Scholars must continue to highlight and develop this context to ensure that contemporary policy debates are grounded in legal and historical norms.

APPENDIX: SELECTED INFRASTRUCTURE CONTRACT PROVISIONS

A. Chicago Parking Meter System Concession Agreement[351]

Section 1.1. Definitions.

> "Reserved Powers" means the exercise by the City of those police and regulatory powers with respect to Metered Parking Spaces, including Concession Metered Parking Spaces and Reserve Metered Parking Spaces, and the regulation of traffic, traffic control and the use of the public way including the exclusive and reserved rights of the City to (i) designate the number and location of Metered Parking Spaces and to add and remove Metered Parking Spaces; (ii) establish and revise from time to time the schedule of Metered Parking Fees for the use of Metered Parking Spaces; (iii) establish and revise from time to time the Periods of Operation and Periods of Stay of Metered Parking Spaces;' (iv) establish a schedule of fines for parking violations; (v) administer a system for the adjudication and enforcement of parking violations and the collection of parking violation fines and (vi) establish and administer peak period pricing, congestion pricing or other similar plans.[352]

Section 3.12. Competing Off-Street Parking.

> (a) Subject to Section 3.12(b) and Section 3.12(c). the City will not operate and will not permit the operation of, a "Competing Public Parking Facility." A "Competing Public Parking Facility" means any off-street public parking lot or public parking garage that (i) is (A) owned or operated by the City or (B) operated by any Person and located on land owned by the City, or leased to the City, (ii) is within one mile of a Concession Metered Parking Space, (iii) is used primarily for general public parking; (iv) has a schedule of fees for parking motor vehicles that is less than three times the highest Metered Parking Fees then in effect for Concession Metered Parking Spaces in the same area; and (v) was not used for general public parking on the effective date of this Agreement.

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351 J. OF THE PROC. OF THE CITY COUNCIL OF THE CITY OF CHIC., ILL., Dec. 4, 2008, *available at* www.chicityclerk.com/journals/2008/dec4_2008/120408_SP.pdf.

352 *Id.* at 50549.

(c) If the City undertakes or permits a Competing Public Parking Facility in violation of Section 3.12(a). such action shall constitute a Compensation Event requiring the payment of Concession Compensation. Such action shall not constitute a City Default, an Adverse Action or a Reserved Powers Adverse Action. No interest in real estate is conveyed by Section 3.12.[353]

Section 3.19. Administration of the Public Way.

The City agrees, and the Concessionaire acknowledges and accepts, that the City holds and administers the public way in trust under the public trust doctrine for the non-discriminatory benefit of all Persons and interests, including the Concessionaire and the Concessionaire Interest. In the administration of its public trust with respect to the public way, the City will not take any action in contradiction of the public trust doctrine that is intended to discriminate against the Concessionaire or the Concessionaire Interest**.** The foregoing provisions of this Section 3.19 are not a limitation of any provision of Article 7 or Section 14.3.[354]

Section 7.1. Metered Parking Fees.

The exercise by the City of its Reserved Power to establish Metered Parking Fees shall not be used to favor the use by the general public of any Other Metered Parking Space located within one mile of any Concession Metered Parking Space or any Reserve Metered Parking Space over the use by the general public of any Concession Metered Parking Space.[355]

Section 7.6. Parking Fines and Enforcement

(a) General Provisions. The Parties acknowledge and agree that effective enforcement of parking rules and regulations by the City and the adjudication and punishment of Persons that violate such rules and regulations are material to the Parties and to the administration of this Agreement… The City covenants that it will enforce parking rules and regulations, as in effect from time to time, in accordance with the provisions of this Section 7.6 and acknowledges that its failure to do so may result in

353 *Id.* at 50573–74.

354 *Id.* at 50576–77.

355 *Id.* at 50582.

losses to the Concessionaire and thereby may constitute a Compensation Event.[356]

(c) Compensation Events. Each of the following shall constitute a Compensation Event: (i) if the City requires more than three final determinations of parking violation liability for a passenger vehicle to become eligible for vehicle immobilization, provided, however, that nothing in this clause (i) limits the City from enacting dollar thresholds for vehicle immobilization eligibility as long as the average tine and penalty value is less than or equal to the average value of three final determinations of parking violation liability, and (ii) if the City offers Persons with unpaid parking fines or penalties the option of paying an amount as full satisfaction of the fine and penalty if that amount is less than ten times the then weighted average hourly Metered Parking Fee for Concession Metered Parking Spaces.[357]

Section 14.1. Adverse Action.

(a) An "Adverse Action" shall occur if the City, the County of Cook or the State of Illinois (or any subdivision or agency of any of the foregoing) takes any action or actions at any time during the Term (including enacting any Law) and the effect of such action or actions, individually or in the aggregate, is reasonably expected (i) to be principally borne by the Concessionaire or other operators of on-street metered parking systems and (ii) to have a material adverse effect on the fair market value of the Concessionaire Interest (whether as a result of decreased revenues, increased expenses or both), except where such action is in response to any act or omission on the part of the Concessionaire that is illegal (other than an act or omission rendered illegal by virtue of the Adverse Action) or such action is otherwise permitted under this Agreement; provided, however, that none of the following shall be an Adverse Action: (A) any action taken by the City pursuant to its Reserved Powers, (B) other than as a result of any action taken by the City pursuant to its Reserved Powers, the development, redevelopment, construction, maintenance, modification or change in the operation of any existing or new parking facility or mode of parking or of transportation (including a road, street or highway) whether or not it results in the reduction of Metered Parking Revenues or in

356 *Id.* at 50582–83.

357 *Id.* at 50587–88.

the number of vehicles using the Metered Parking System, (C) the imposition of a Tax of general application or an increase in Taxes of general application, including parking Taxes of general application imposed on customers or operators of parking facilities, or (D) requirements generally applicable to public parking lot licensees including "public garage-not enclosed" licensees under the Municipal Code.

(b) If an Adverse Action occurs, the Concessionaire shall have the right to (i) be paid by the City the Concession Compensation with respect thereto (such Concession Compensation, the "AA-Compensation") or (ii) terminate this Agreement and be paid by the City the Metered Parking System Concession Value, in either case by giving notice in the manner described in Section 14.1(c).[358]

Section 14.3. Reserved Powers Adverse Actions.

(a) Use of Reserved Powers. The Parties acknowledge and agree that (i) it is anticipated that the City will exercise its Reserved Powers during the Term, (ii) the impact of certain of such actions may have a material adverse effect on the fair market value of the Concessionaire Interest; (iii) the provisions of Article 7. including the provisions thereof relating to the payment of Settlement Amounts by the City, are designed to compensate the Concessionaire for changes resulting from the exercise by the City of its Reserved Powers in a manner that will maintain the fair market value of the Concessionaire Interest over the Term and (iv) adverse changes may be mitigated by other Reserved Power actions of the City that will have a favorable impact on the fair market value of the Concessionaire Interest. The Parties also acknowledge and agree that there may be circumstances when the exercise by the City of its Reserved Powers may have a material adverse effect on the fair market value of the Concessionaire Interest that cannot be compensated fully under the provisions of Article 7 and that under such circumstances the Concessionaire may seek compensation with respect thereto (the "Reserved Powers Adverse Action Compensation").

(b) Reserved Powers Adverse Action. A "Reserved Powers Adverse Action" shall occur if (i) the City takes any action or actions during the Term that would otherwise have constituted an

358 *Id.* at 50618–19.

> Adverse Action under Section 14.1 except that such action or actions were taken by the City pursuant to its Reserved Powers, and (ii) such actions, individually or in the aggregate, are reasonably expected (A) to be home principally by the Concessionaire or other operators of on-street metered parking systems and (B) to have a material adverse effect on the fair market value of the Concessionaire Interest after taking into account the pro-visions of Article 7. In addition, the events described in Section 7.10 relating to a reduction of Concession Metered Parking Spaces or to the average of the Monthly System in Service Percentage for certain Reporting Years being less than eighty percent (80%) are each a Reserved Powers Adverse Action.

B. South Bay Expressway (SR 125) Agreement[359]

Developer has the right to seek compensation for "losses" in certain events and Caltrans agrees and understands that Developer is entitled to seek compensation for losses resulting from the occurrence of any of the following operative events:

> (a) The State legislature, the California Transportation Commission, or any other administrative agency or authority of the State enacts, adopts, promulgates, modifies, repeals, or changes any State law, rule, initiative, referendum, constitutional provision, or regulation, all or any of which has the effect of
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> (i) directing Caltrans to acquire the Transportation Facility or portion thereof,
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> (ii) terminating, limiting, reducing, or abrogating the rights or benefits of Developer under this Agreement, or
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> (iii) regulating or interfering with Developer's right to establish and collect tolls;
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> (b) The voters of the State, by initiative, referendum, or other ballot measure, enact, adopt, promulgate, modify, repeal, or change any State law, rule, initiative, referendum, constitutional provision, or regulation, all or any of which has the effect of
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> (i) directing Caltrans to acquire the Transportation Facility or portion thereof,

359 Dannin, *supra* note 3 at 103.

(ii) terminating, limiting, reducing, or abrogating the rights or benefits of Developer under this Agreement, or

(iii) regulating or interfering with Developer's right to establish and collect tolls; or

(c) Any court issues any order, decree, or judgment which has the effect of

(i) directing Caltrans to acquire the Transportation Facility or portion thereof,

(ii) terminating, limiting, reducing, or abrogating, the rights or benefits of Developer under this Agreement,

(iii) declaring illegal, void, or ultra vires any portion of this Agreement or voiding the rights of Developer under this Agreement, or

(iv) regulating or interfering with Developer's right to establish and collect tolls.