

Constitutional Highlights

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Wisconsin Constitution Article I, Section 12 THE CONTRACT CLAUSE

No...law impairing the obligation of contracts, shall ever be passed....

History and purposes

Both the U.S. Constitution and the Wisconsin Constitution prohibit the state from enacting a law “impairing the obligation of contracts.” Art. I, Sec. 10, U.S. Const.; Art. I, Sec. 12, Wis. Const. This prohibition, called the “contract clause,” is generally interpreted to prohibit the government from retroactively interfering with matters that are governed by private contracts.

Early courts generally interpreted the contract clause as prohibiting the state from impairing substantive obligations under existing contracts. For example, in *Sturgis v. Crownshield*, 17 U.S. 122 (1819), the court held that a New York bankruptcy statute violated the contract clause. Similarly, in *Green v. Biddle*, 21 U.S. 1 (1823), the court held that a Kentucky law exempting an occupant of land from the payment of rent to the landowner violated the contract clause.

Early courts, however, distinguished between laws that impair substantive contractual obligations and laws that impair contractual remedies. Even early courts permitted the state to change the remedies that a party may obtain for breach of contract and the process a party must follow to obtain these remedies. See *Mason v. Hale*, 25 U.S. 370 (1827) (allowing states to regulate or abolish imprisonment for debt as a remedy for enforcing contracts). The state, though, could not completely remove a party’s means of enforcing a contract or change the enforcement process to such an extent as to substantially impair the party’s contractual rights. See *Richmond Mortg. & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 U.S. 124, 128-29 (1937).

The courts eventually repudiated the strict interpretation of the contract clause in favor of an interpretation that allowed the state more authority to exercise regulatory powers. In 1934, the U.S.

Supreme Court cautioned that the prohibition in the contract clause “is not an absolute one and is not to be read with literal exactness like a mathematical formula.” *Home Building and Loan Ass’n v. Blaisdell*, 290 U.S. 398, 428 (1934). Rather, the state “continues to possess authority to safeguard the vital interest of its people,” even if the exercise of that authority impairs existing contractual obligations. *Blaisdell*, 290 U.S. at 434. Or, as the Wisconsin Supreme Court later stated, “the obligation of contract is not an absolute right, but is one that may be obliged to yield to the compelling interest of the public – the exercise of the police power.” *State ex. rel. Building and Manager’s Ass’n. v. Adamany*, 64 Wis. 2d 280, 292 (1974). Here, the term “police power” has a broad meaning and includes the state’s general power to regulate the activities of businesses and individuals for the protection of life, health, safety, comfort, property, and prosperity, the preservation of order, and the promotion of the general welfare.

How courts currently interpret the section

Both the Wisconsin courts and the federal courts currently use the same multipart analysis to determine if a statute violates the contract clause. The threshold inquiry in any contract clause analysis is to determine whether the challenged statute operates as a substantial impairment of a contractual relationship. If the statute operates as only a minimal impairment (or no impairment), then the statute does not violate the contract clause. If the statute operates as a substantial impairment, then the court determines if the legislation has a significant and legitimate public purpose. Finally, if the legislation has a public purpose, the court will decide if the legislation is based upon reasonable conditions and is appropriate to that public purpose. *Chappy v. Labor and Industry Review Com.*, 136 Wis. 2d 172, 187-88 (1987).

Is there a substantial impairment of a contractual relationship?

In determining whether a law substantially impairs existing contractual rights, a key factor is the extent to which the effect of the challenged law was foreseeable when the contract was made. *Chrysler Corp. v. Kolosso Auto Sales*, 148 F. 3d 892, 894-95 (7th Cir. 1999). During contract negotiations, the parties can take into account the potential effects of foreseeable changes in the law. The parties may reasonably expect such foreseeable changes to affect their contract. If the effect of a particular statute is foreseeable, then its enactment is less likely to be held a substantial impairment. This respect and support for the freedom of parties to bargain and for the protection of each party’s reasonable expectations are public policies underlying much of contract law.

The case of *Pfister v. Milwaukee Econ. Dev. Corp.*, 216 Wis. 2d 243 (Ct. App. 1998), exemplifies the interesting role of foreseeability in contract clause cases. In this case, a former employee (Pfister) sued to enforce a lien for unpaid wages owed by his former employer, Precision Analytical Laboratory, Inc. (PAL). As a result of a 1993 statutory change, Pfister’s wage lien had priority over all other secured claims against PAL. Other creditors, who had perfected their liens against PAL even before Pfister first began employment with PAL, resisted Pfister’s suit, arguing that retroactively applying the wage lien statute to give Pfister’s claim a higher priority would unconstitutionally impair their contractual rights against PAL.

The court disagreed, holding that the wage lien statute did not impair the creditors contract rights because the wage lien statute did not alter the creditors' reasonable expectations under their contracts with PAL. *Pfister*, 216 Wis. 2d 260-63. Put another way, the *effect* of the wage lien statute (to transfer amounts owed for wages from PAL to its employees, making the amounts unavailable for collection by creditors) was foreseeable at the time the creditors entered into their contracts.

Another factor in determining whether a law substantially impairs existing contractual rights is the law's financial impact upon contracting parties.

Does the statute have a sufficient and legitimate public purpose?

Although the assessment of the public purpose behind a challenged statute requires a case-by-case analysis, court decisions provide some broad principles. First, the courts generally recognize the legislature as the branch of government that is responsible for defining the public interest. Thus, the courts give deference to the legislature in assessing the extent to which a statute accomplishes a public purpose. In Wisconsin, this policy of respect for the legislature is expressed as a function of the burden of proof. A person challenging a statute under the contract clause must show beyond a reasonable doubt that the statute is an unconstitutional impairment. *Wis. Prof'l. Police Ass'n v. Lightbourn*, 243 Wis. 2d 512, 593 (2001).

Second, courts examining the public purpose behind a challenged law are more likely to uphold a statute that protects a broad societal interest rather than the limited interest of particular individuals or groups. Finally, on numerous occasions, the courts have held that a statute that addresses emergencies has a sufficient and legitimate public purpose.

The case of *Overlook Farms Home Ass'n v. Alternative Living Services*, 143 Wis. 2d 485 (1988), illustrates some of these principles. In *Overlook Farms*, Alternative Living Services (ALS) attempted to locate a group home in a residential neighborhood. However, a restrictive covenant prohibited the use of the property for this purpose. The restrictive covenant was of only minimal concern to ALS, though, because a state law declared that such restrictive covenants had no effect. Overlook Farms Home Association (association) sued to stop the siting of the ALS group home, arguing that the retroactive application of the state law unconstitutionally impaired its contract rights under the restrictive covenant.

The court found that the statute did substantially impair the association's contract rights and then moved to the question of whether the statute was enacted for a sufficient and legitimate public purpose. To answer this question, the court looked to the legislature's assessment of the public purpose, as evidenced by a statement of legislative intent included in the enactment. *Overlook Farms*, 143 Wis. 2d at 497-98. The court also examined the societal interest protected by the statute: facilitating the movement of individuals from institutions to their own homes. As part of this examination, the court referred to scholarly literature on the topic, which stated that the siting of group homes was a "broad health and social problem." *Overlook Farms*, 143 Wis. 2d at 498. Based upon this analysis, the court held that the law

accomplished a public purpose that was both sufficient and legitimate and thus justified impairing the association's contract rights. *Id.*

Is the legislation reasonable and appropriate to the public purpose?

Although the determination of whether a challenged statute is reasonable and appropriate requires a case-by-case analysis, court decisions provide some broad principles. First, courts again will generally defer to the legislature as the branch of government that is primarily responsible for making public policy. As stated by the U.S. Supreme Court, judges “should properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.” *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 505 (1987).

However, courts may examine whether the challenged statute is specifically tailored to address the public purpose that motivated its enactment. In addition, the courts may examine whether legal protections are in place to limit the potential harm done by the impairment at issue. Again the *Overlook Farms* case is illustrative. After holding that the siting of group homes in residential neighborhoods was a sufficient and legitimate public purpose, the court then questioned whether the challenged statute was based upon reasonable conditions and was appropriate to the public purpose. The court analyzed both the challenged statute and other applicable law before holding that the statute was reasonable and appropriate. Of particular importance were other laws imposing group home licensing requirements, operating regulations, and limitations on the number of group homes in any particular area, which together lessened the impact upon and risk to affected neighborhoods.

Strategies for reconciling legislation with the section

Include an initial applicability provision

Because the contract clause deals only with the retroactive application of legislation to existing contracts, the Legislative Reference Bureau has developed a nonstatutory provision to specify that the particular legislation applies only to contracts that are made or modified after the legislation takes effect. By including such a provision in a law, the legislature may entirely avoid the application of the contract clause, but it also forgoes any possibility of retroactively affecting existing contracts.

Use a statement of legislative purpose

Because the courts grant great deference to the legislature in contract clause cases, a statement of legislative purpose can be useful for the legislature to communicate relevant information to the courts. For example, the legislature may use a statement of legislative purpose to communicate both the public purpose behind legislation that impairs existing contractual rights and the reasons that the impairment is reasonable and appropriate.

Rely on scholarly experts and publications

If academic experts and scholarly publications discuss the broad, societal need for particular legislation, a

provision may avoid a contract clause challenge if it is consistent with these expert opinions. The committee may include the testimony and published work of experts in the committee record for the proposal.

Include safeguards that limit the potential impairment

If legislation is likely to impact private interests that are set out in contract, a provision may include safeguards, such as narrowly drawn regulations of the activity which impairs contracts, to lessen the impact upon those interests.



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