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Constitutional Law--Power of Congress to Nullify Contractual Obligations

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NOTES AND COMMENT

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CONSTITUTIONAL LAW—POWER OF CONGRESS TO NULLIFY CONTRACTUAL OBLIGATIONS.

Chief Justice Hughes, when Governor of New York, once said, "We are under a Constitution, but the Constitution is what the judges say it is." [1] That this statement is true admits of no doubt. The history of the Supreme Court shows that, from the days of Chief Justice Marshall until this very minute, the Constitution has been subjected to judicial enlargement, interpretation and invention.[2] To-day, "the Court, as heir to the accumulated doctrines of its predecessors, now finds itself in possession of such a variety of instruments of constitutional exegesis that it is able to achieve almost any result in the field of constitutional interpretation which it considers desirable, and that without flagrant departure from judicial good form." [3]

This capability of variable achievement is by no means capricious and dependent solely upon the whim of the Court. The fundamental principles of the Constitution must be subserved, but because the Constitution is not a fixed definition of static rights as of the day of its adoption and was designed rather as a document capable of reflecting future economic and social changes,[4] these principles must be taken into consideration by the Court. It must, in the words of Justice Cardozo, "exercise a discretion informed by tradition, methodized by analogy, disciplined by system and subordinated to the primordial necessity of order in the social life." [5] In other words, the broad discretion of the Court, finding its reason of necessity in the Constitution, is tinged with an equally broad moral responsibility for the safety and welfare of the nation.[5a]

Nowhere was this psychology of the Court more forcefully revealed than in the "Gold Cases." [6] Confronted with a situation which, because of the pressing needs of the national economy, required immediate solution, the Court, because of the gravity of the decision, took almost a month to decide the cases. What the Court was going

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[1] HUGHES, ADDRESSES (1909) 139.

[2] CORWIN, TWILIGHT OF THE SUPREME COURT (1934) 180 *et seq.*

[3] *Id.* at 181.

[4] 1 WILLOUGHBY ON THE CONST. OF THE U. S. (2d ed. 1929) §43; THE FEDERALIST, No. XXXI (1788) 182; CORWIN, *supra* note 2, at 7.

[5] CARDOZO, NATURE OF THE JUDICIAL PROCESS (1921) 141.

[5a] CORWIN, *supra* note 2, at 82.

[6] Norman v. Baltimore & O. R. Co., — U. S. —, 55 Sup. Ct. 407 (1935); Nortz v. United States, — U. S. —, 55 Sup. Ct. 428 (1935); Perry v. United States, — U. S. —, 55 Sup. Ct. 432 (1935).

to decide, no one could forecast.[7] Strong arguments based on judicial precedent were advanced by both sides.[8] Which way would the Court turn? Would it consider upholding the sanctity of the obligations of private contracts a social duty paramount in importance to that of upholding the monetary policy of Congress; a tenet closer in harmony to the fundamental principles of the Constitution? Would it approve the partial repudiation by Congress of government bonds and promises as "the primordial necessity of order in the social life," or would it consider such repudiation an act too dangerous to the public welfare and security and too far removed from fundamental principles to condone? What the Court decided is history. It remains for us to analyze the decisions and to try to uncover the reasoning underlying them.

Virtually all private and public bonds outstanding in 1933 contained the gold clause which, though slightly different in language in individual cases, was of the same general import;[9] that is, a promise to pay to the obligee in gold coin. The object of the clause was to protect the parties against inflation and deviation from the gold standard, though it must be confessed that, until the present economic depression, the possibility of such changes was always remote and of little weight in the minds of the contracting parties.[10] Nevertheless, it has been estimated that anywhere from 50 to 100 billion dollars of the funded indebtedness in this country contained at the time a gold clause or a modification thereof.[11]

The impossibility of actually redeeming all these obligations in gold coin led to two serious dangers which threatened what economic security remained; first, the tendency to hoard gold; second, the tendency of capital to leave the country.[12] In recognition of the danger and to alleviate the situation, Congress took legislative action and by a Joint Resolution on June 5, 1933 declared such clauses void and all obligations containing them dischargeable in any current legal

[7] N. Y. Times, Jan. 12, 1935, at 1, col. 2; N. Y. World-Telegram, Jan. 21, 1935, at 17; N. Y. Herald Tribune, Jan. 16, 1935, at 1.

[8] N. Y. Times, Jan. 9 to 12, 1935, at 1.

[9] The gold clauses contained in the obligations sued on in the instant cases are indicative of the language used. In the Norman case, the bond provided for the payment of principal and interest in gold coin of the United States of America of or equal to the standard of weight and fineness existing on the date of issue; in the Bankers Trust Co. case (decided in the same opinion with the Norman case), the bond provided for payment of principal and interest in gold coin of the United States of the present standard of weight and fineness; the gold certificate in the Nortz case contained a promise to pay $1,000 in gold coin payable to the bearer on demand; and in the Perry case, the Liberty Bond provided that "the principal and interest hereof are payable in United States gold coin of the present standard of value."

[10] Nebolsine, *Gold Clause in Private Contracts* (1933) 42 YALE L. J. 1051-2.

[11] *Ibid*, n. 3; Post and Willard, *Power of Congress to Nullify Gold Clauses* (1933) 46 HARV. L. REV. 1225, n. 2; N. Y. Times, Jan. 9, 1935, at 1; N. Y. World-Telegram, *supra* note 7.

[12] Norman v. Baltimore & O. R. Co., *supra* note 6, at 418.

tender, dollar for dollar.[13] The resolution included within its scope government obligations.[14] This act was only one cog in the legislative and executive machinery set moving to prevent the efflux of gold from the country and the hoarding of gold within its borders.[15] The culmination of the entire process resulted in the President's proclamation on January 31, 1934, when he fixed the weight of the gold dollar at 15 5/21 grains nine-tenths fine,[16] a reduction of 41 per centum from its previous weight of 25.8 grains nine-tenths fine.[17]

By reason of the Joint Resolution and the President's proclamation of January 31, 1934, holders of private or public bonds were affected in this fashion—they could be repaid only in current legal tender (the status of gold as legal tender had been abolished [18]) and they had to accept a dollar for dollar amount despite the devaluation of the gold dollar. Four test cases arose almost immediately:

1. *Norman* v. *Baltimore & O. R. Co.*, a suit on a coupon of a bond issued by the defendant,[19]
2. *In re Missouri Pac. R. Co.*, a suit on matured bonds,[20]
3. *Nortz* v. *U. S.*, a suit on gold certificates surrendered under protest to the Secretary of the Treasury pursuant to his order of January 15, 1934,[21]
4. *Perry* v. *U. S.*, a suit on a Liberty Bond called for redemption on April 15, 1934.[22]

The first two being suits on private bonds were disposed of in one opinion; the other two, involving different questions, were decided in separate opinions.

In the first decision, entitled *Norman* v. *Baltimore & O. R. Co.*,[23] the validity of the Joint Resolution was upheld. It was the contention of the plaintiffs that the resolution was unconstitutional, first, because it operated to deprive them of their property without due process of law, in that it destroyed valuable contract rights by denying effect to gold clauses in existing contracts in violation of the

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[13] 41 STAT. 112, 31 U. S. C. A. §463 (1933).
[14] Perry v. United States, *supra* note 6, at 434.
[15] See Norman v. Baltimore & O. R. Co., *supra* note 6, at 410 *et seq.*, for an excellent review of the action taken by the President and Congress from March 6, 1933 to Jan. 31, 1934.
[16] Executive Order of Jan. 31, 1934 (No. 2072), 31 U. S. C. A. §821, note.
[17] 31 STAT. 45 (1900), 31 U. S. C. A. §314 (1925).
[18] Executive Order of March 10, 1933 (No. 6073), 12 U. S. C. A. §95, note; Executive Order of April 5, 1933 (No. 6102), 12 U. S. C. A. §248, note.
[19] 265 N. Y. 37, 191 N. E. 726 (1934); (1934) 9 ST. JOHN'S L. REV. 197; (1935) 83 U. OF PA. L. REV. 682.
[20] 7 F. Supp. 1 (E. D. Mo. 1934); (1935) 83 U. OF PA. L. REV. 88.
[21] *Supra* note 6, on certificate from the Court of Claims.
[22] *Supra* note 6, on certificate from the Court of Claims.
[23] *Supra* note 6.

Fifth Amendment,[24] and second, because it violated the Tenth Amendment.[25] The argument on this score was advanced by counsel for Mr. Norman as follows: "Since this is a government of enumerated powers and no provision is made whereby Congress can impair contracts, it follows that it has no such power." [26]

The answer of the Court to these contentions is a model of constitutional interpretation and reasoning. Finding first that the contracts before them were contracts for the payment of money and not for the payment in gold coin as a commodity, or in bullion,[27] it then proceeded to examine (1) the power of Congress to establish a monetary system; (2) the power of Congress to invalidate the provisions of existing contracts which interfere with the exercise of its constitutional authority; and (3) the effect of the gold clauses in relation to the monetary policy adopted by Congress.

The express grant to Congress of the power "to coin money, regulate the value thereof, and of foreign coin," [28] the Court states, is not the full measure of Congressional authority in relation to the currency. The related powers to lay and collect taxes, to borrow money, to regulate foreign and interstate commerce, to fix the standards of weights and measures, together with the express power "to make all laws which shall be necessary and proper for carrying into execution the enumerated powers" [29] comprise, with the express grant of power, the comprehensive authority of Congress over matters of finance, revenue and currency. Since entire power over the currency is vested in Congress, it has been held that Congress may eliminate state bank notes from circulation in order to exclude the use of all currencies but its own,[30] it may declare something besides gold and silver legal tender,[31] and it may exercise the money power and the power of eminent domain to prohibit gold hoarding.[32]

But, plaintiff contended, the power of Congress to establish a monetary system cannot be extended to the striking down of express

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[24] U. S. CONST. AMEND. V. (No person * * * shall be deprived of life, liberty, or property, without due process of law.)

[25] U. S. CONST. AMEND. X. (The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.)

[26] N. Y. Times, Jan. 9, 1935, at 2.

[27] Since the Court in its opinion declares that the validity of the Joint Resolution would have been upheld in either case, further discussion of the differences in legal effect of these interpretations will not be attempted here. The interested reader will find a keen analysis of this problem in Nebolsine, *Gold Clause in Private Contracts*, *supra* note 10.

[28] U. S. CONST. Art. I, §8, par. 5.

[29] *Id.* Art. I, §8, par. 18.

[30] Veazie Bank v. Fenno, 8 Wall. 533 (U. S. 1869).

[31] Legal Tender Cases, 12 Wall. 457 (U. S. 1870); Juillard v. Greenman, 110 U. S. 421, 4 Sup. Ct. 122 (1884).

[32] Campbell v. Chase National Bank, 5 F. Supp. 156 (S. D. N. Y. 1933); *cf.* Ling Su Fan v. United States, 218 U. S. 302, 31 Sup. Ct. 21 (1910) (the power to coin money involves the power to prohibit its export, mutilation and melting).

contracts for gold payments. To this the Court answered, "contracts, however express, cannot fetter the constitutional authority of the Congress. Contracts may create rights of property, but, when contracts deal with a subject-matter which lies within the control of the Congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of dominant constitutional powers by making contracts about them.[33] Such contracts must be understood as having been made in reference to the possible exercise of the rightful authority of the Government.[34] Moreover, the exercise of rightful authority has not been limited in its validity to where its interference with private contracts has been an incidental effect, but it has also been upheld where, in the carrying out of a lawful policy, it has expressly prohibited and invalidated contracts previously made and valid when made.[35]

With these principles in mind, the Court proceeded to answer the question, "Did the gold clauses before them interfere with the policy of Congress in the exercise of its authority to establish the monetary system of the country?" The Court used the test of *McCulloch* v. *Maryland*;[36] that is, whether the action of Congress bore a reasonable relation to a legitimate end or was solely capricious and arbitrary.[37] Reviewing the circumstances outlined above, which called into being the Joint Resolution, the Court found that Congress, to reach a legitimate end (the establishment of a sound monetary system), was entitled to reject a dual system in which gold was above a parity with other legal tender and adopt a uniform system placing all legal tender on a parity and withdrawing gold from circulation, thereby destroying its status as legal tender; that the means adopted bore a reasonable relation to the end; and that gold clauses in private contracts must give way to the declared policy of Congress. The purpose of the Resolution was "not to confiscate property but to restore normal and sound valuations of property." [38]

The dissenting justices [39] could not see eye to eye with the majority. To them, "the end or objective of the Joint Resolution was

[33] Norman v. Baltimore & O. R. Co., *supra* note 6, at 416.

[34] Knox v. Lee, 12 Wall. 457 (U. S. 1870); Hudson County Water Co. v. McCarter, 209 U. S. 349, 357, 28 Sup. Ct. 529 (1907); Louisville & Nashville R. Co. v. Mottley, 219 U. S. 467, 482, 31 Sup. Ct. 265 (1910); United States v. Southern Pac. Co., 259 U. S. 214, 234, 42 Sup. Ct. 496 (1921); Stephenson v. Binford, 287 U. S. 251, 276, 53 Sup. Ct. 181 (1932); BURDICK, THE AMERICAN CONSTITUTION (1922) §91.

[35] Mondou v. N. Y., N. H. & H. R. Co., 223 U. S. 1, 52, 32 Sup. Ct. 169 (1911); Phila., Balt. & Wash. R. R. Co. v. Schubert, 224 U. S. 603, 32 Sup. Ct. 589 (1911); Sproles v. Binford, 286 U. S. 374, 390, 52 Sup. Ct. 581 (1931).

[36] 4 Wheat. 316 (U. S. 1819).

[37] *Id.* at 421, 423.

[38] Collier, *Gold Contracts and Legislative Power* (1934) 2 GEO. WASH. L. REV. 303, 362.

[39] They were Messrs. Justices McReynolds, Van Devanter, Sutherland and Butler, the so-called "conservative" group on the Supreme Court bench.

not 'legitimate.' The real purpose was 'not to assure uniform value to the coins and currencies of the United States,' but to destroy certain valuable contract rights."[40] The Fifth Amendment they considered to be an insuperable bar to the validity of the Resolution. If the destruction of the gold clauses was for public benefit, they argued, then proper compensation was essential; if for private benefit, the due process clause barred the way. To acquiesce in the confiscation of property rights would be to fail in their "obligation of responsibility."

Will not the careful student of the majority and the dissenting opinions come to the conclusion that, in their honest search for the fundamental principles of the Constitution pertinent to the question before them, the justices who upheld the validity of the Joint Resolution found the fundamental principle to be "the primordial order of necessity in the social life," while the dissenting justices were concerned more with the rights of the individual? For it is true that "the greatest problem of statesmanship at the present time is to preserve the fundamental rights of the individual as guaranteed by the Constitution without impairing the power of the government to undertake measures essential to the general welfare."[41] Which of the two considerations will prevail in any given case, depends largely on which the judges consider to be more fundamentally aligned with the purpose of the Constitution.

No question of the validity of the Joint Resolution was broached in the case of *Nortz* v. *U. S.* There it was one only of just compensation. The basis of plaintiff's claim was that he was entitled, by the terms of the gold certificates, to receive gold coin when he turned them in on January 17, 1934; that for each \$20.67 of certificates, he was entitled to one ounce of gold which in the gold markets of the day was worth \$33.43; and that the difference between what he received in legal tender non-redeemable in gold and what the equivalent number of gold coin dollars would have brought him in the world market was the measure of his damages. To this the Court made answer that the gold certificates were not warehouse receipts calling for a quantity of gold as a commodity or bullion, but currency calling for dollars. Therefore, if plaintiff had received dollars in gold coin, he would have forthwith been required to deliver them up to the treasury under the applicable legislation and orders, receiving legal tender in return. He could not export it or deal in it. The value of gold in the world market could mean nothing to him, since Congress had prohibited its exportation.[42] He therefore suffered no

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[40] Norman v. Baltimore & O. R. Co., *supra* note 6, at 425.

[41] Parker, *Federal Constitution in a Period of Change* (1934) 9 Jour. Nat. Ass'n of Referees in Bankruptcy 79.

[42] Ling Su Fan v. United States, *supra* note 32; Executive Orders, *supra* note 18.

actual damages and since the Court of Claims "was not instituted to try such a case,"[43] his cause of action could not be entertained.

The dissent interpreted the gold certificates to be warehouse receipts for the return of gold left on deposit and from this premise concluded that Congress had broken the promise of the Government to return it and that plaintiff suffered actual damages thereby. If we adopt this premise, the conclusion is correct. But that the premise adopted by the majority is the correct one is more amenable to reason, especially when we consider that had it been in the mind of Congress to constitute the gold certificates warehouse receipts, it would not have provided that the amount of the certificates outstanding "shall not at any time exceed twenty per centum beyond the amount of coin and bullion in the treasury."[44] Were these certificates warehouse receipts, their number could not exceed the amount of gold on deposit.

In the opinion of the writer, the last case, *Perry* v. *U. S.*, is the most interesting of all. There suit was brought on a $10,000 Liberty Bond containing a gold clause, which matured April 15, 1934. It was presented for payment; plaintiff demanded 10,000 gold dollars of 25.8 grains .9 fine or 16,931.35 gold dollars of 15 5/21 grains .9 fine or $16,931.35 in legal tender currency. The defendant tendered $10,000 in legal tender currency and refused plaintiff's demands, on the authority of the Joint Resolution. This, plaintiff claimed, was unconstitutional for the same reasons advanced by the plaintiffs in the *Norman* case.

The Court followed a different line of reasoning in dealing with this case, but reached the same practical result. The question as they saw it was "whether the Congress can use that power [to establish a monetary system] so as to invalidate the terms of the obligations which the Government has theretofore issued in the exercise of the power to borrow money on the credit of the United States."[45] The promise in the bond to repay in gold coin of the present standard of value was intended to afford protection against loss through a possible subsequent standard lower in value. This promise, on the Government's plighted faith, based on express constitutional authority to borrow money and fix the terms of payment,[46] Congress could not later repudiate under the guise of establishing a monetary policy. While Congress can control private contracts which interfere with the exercise of its constitutional authority, yet in respect of its own engagements, the Government is competent to make them binding[47]

[43] Grant v. United States, 7 Wall. 331, 338 (U. S. 1868); Marion & Rye Ry. Co. v. United States, 270 U. S. 280, 282, 46 Sup. Ct. 253 (1925).

[44] 12 STAT. 711 (1863), 31 U. S. C. A. §428 (1925).

[45] Perry v. United States, *supra* note 6, at 434, 435.

[46] U. S. CONST. Art I, §9, par. 2.

[47] Perry v. United States, *supra* note 6, at 436, n. 3.

and incurs rights and responsibilities similar to those of individuals.[48] The Constitution expressly forbids the questioning of the validity of the public debt.[49] It would seem, therefore, that in this country, where the actions of the administrative bodies of the Government are open to judicial review, wholesale repudiation of government debts like those instanced across the Atlantic are impossible.

Having found that the Joint Resolution of June 5, 1933, in so far as it attempted to override the obligation created by the bond in suit went beyond the congressional power, the Court goes on to the question of damages and, following the reasoning of the *Nortz* case, finds that the plaintiff suffered only nominal damages, and hence has no action. "This," the dissenting opinion declares, "amounts to a declaration that the government may give with one hand and take away with the other." [50] With the conclusion that the government could not repudiate its engagements it agreed, but the damages, in accordance with the reasoning running throughout the dissent, it held to be substantial. Justice Stone, on the other hand, handed down a concurring opinion in which he said, "As much as I deplore this refusal to fulfill the solemn promise of bonds of the United States, I cannot escape the conclusion, announced for the Court, that in the situation now presented, the government, through the exercise of its sovereign power to regulate the value of money, has rendered itself immune from liability for its action." [51] It appeared to him that in placing government obligations on a higher plane than private bonds, the Court was imposing serious restrictions in the path of measures to stabilize the dollar, because then actual damages might be shown.

It appears that the Court was unwilling to sanction the repudiation of government engagements, because to do so would constitute the pledge of the United States an illusory and vain promise and place us in the category of the European debtor nations, but it was equally unwilling to jeopardize the program of stabilization which Congress had undertaken for the benefit of the people. The result was a compromise in which only four of the justices could acquiesce. But since Justice Stone's misgivings could easily be dispelled by legislative restriction of the jurisdiction of the Court of Claims,[52] the opinions present a unified front of approval of measures taken to rehabilitate the economic security and the public welfare of the nation.

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[48] Sinking Fund Cases, 99 U. S. 700 (1878); United States v. Bank of the Metropolis, 15 Pet. 377 (U. S. 1841) (except that the United States cannot be sued without its consent).

[49] U. S. CONST. AMEND. XIV.

[50] Norman v. Baltimore & O. R. Co., *supra* note 6, at 426.

[51] Perry v. United States, *supra* note 6, at 438.

[52] N. Y. Times, Feb. 19, 1935, at 1, col. 8, 17, col. 8.