

# WISCONSIN

## LEGISLATIVE REFERENCE BUREAU

### The Contract Clause

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# The Contract Clause

## Wisconsin Constitution, Article I, Section 12

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

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In its Declaration of Rights, the Wisconsin Constitution provides that no “law impairing the obligation of contracts, shall ever be passed.”<sup>1</sup> This provision is known as the “contract clause” (hereinafter, the “state contract clause”) and is based on the Contract Clause of the U.S. Constitution, which prohibits states from passing laws that impair the obligation of contracts (hereinafter, the “federal contract clause”).<sup>2</sup> The constitutions of 39 other states include a similar contract clause.<sup>3</sup>

Wisconsin’s contract clause originated in the state’s first constitutional convention of 1846. The convention’s delegates drafted a clause that prohibited laws “impairing the validity of contracts.”<sup>4</sup> The first convention considered three amendments to that prohibition. One of the amendments would have prohibited interfering with or affecting private contracts, and another would have prohibited depriving parties to a contract of any remedy that existed when the contract was made. Both of those amendments were rejected without any recorded debate.<sup>5</sup> A third amendment would have prohibited any retroactive law impairing the validity or remedy of contracts.<sup>6</sup> That amendment was debated, but ultimately re-

jected.<sup>7</sup> A reporter observed that the convention probably concluded that the amendment was not necessary based on U.S. Supreme Court decisions regarding the scope of the similarly worded federal contract clause.<sup>8</sup>

After voters rejected the constitution drafted by the 1846 convention,<sup>9</sup> a second constitutional convention was held in 1847. The second convention made only one change to the clause drafted by the first convention. Without debate, the second convention prohibited impairing the “obligation” of contracts instead of their “validity.”<sup>10</sup> As a result, when voters ratified the second convention’s constitution, the language of the state contract clause was made consistent with that of the federal contract clause. In interpreting the state contract clause, the Wisconsin Supreme Court has relied for guidance on the U.S. Supreme Court’s interpretation of the federal contract clause. Therefore, to understand how Wisconsin courts have interpreted the state contract clause, it is helpful to review the federal contract clause.

## The federal contract clause

### Framers’ intent

What did the framers of the U.S. Constitution intend regarding the scope of the federal contract clause? One scholar has concluded: “There is very little reason to think that the framers had any theory about the contract clause, or pondered its implications for cases to which

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1. WIS. CONST. art. I, § 12.

2. U.S. CONST. art. I, § 10.

3. The constitutions of the following states do not have a similar contract clause: Connecticut, Delaware, Hawaii, Kansas, Maryland, Massachusetts, New Hampshire, New York, North Carolina, and Vermont. However, two of those states (Hawaii and New York) have a narrower type of clause that prohibits the impairment of public sector retirement benefits. Alaska, Illinois, and Michigan have constitutions with both types of clauses.

4. See THE CONVENTION OF 1846, in 27 PUBLICATIONS OF THE STATE HISTORICAL SOCIETY OF WISCONSIN, 749 (Milo M. Quaife, ed., 1919).

5. *Id.* at 372–73.

6. *Id.* at 369.

7. *Id.* at 371–72, 374–85.

8. See THE STRUGGLE OVER RATIFICATION 1846–1847, in 28 PUBLICATIONS OF THE STATE HISTORICAL SOCIETY OF WISCONSIN, 115 (Milo M. Quaife, ed., 1920).

9. The rejection was due to controversy over the constitution’s restrictions on banking, its homestead exemption, and its guarantee of separate property rights for married women. Joseph A. Raney, *The Making of the Wisconsin Constitution*, WISCONSIN LAWYER, Sept. 1992, at 15.

10. See THE ATTAINMENT OF STATEHOOD, in 29 PUBLICATIONS OF THE STATE HISTORICAL SOCIETY OF WISCONSIN, 275 (Milo M. Quaife, ed., 1928).

it applied.<sup>11</sup> However, other scholars have argued that the framers intended the clause to broadly prohibit any state law that violates vested contractual rights by transferring all or part of the benefit of a bargain from one party to another.<sup>12</sup>

Still other scholars have theorized that, despite the federal contract clause's broad, unqualified language, the framers intended it to have a narrower meaning. The leading theory is that the clause was intended to prohibit states from passing debtor relief laws that impaired creditors' rights.<sup>13</sup> During the economic depression following the Revolutionary War, debts mounted and creditors sought to enforce their rights via foreclosures. In response, the former colonies enacted debtor relief laws to suspend debts and stay foreclosures.<sup>14</sup> According to some scholars, the framers recognized that the new nation's economic growth "depended in large measure on providing a stable environment for those who had money to invest or loan," and therefore drafted the clause to restrict the power of states to void credit arrangements.<sup>15</sup>

Another narrow theory is that the federal contract clause was intended to apply only to contracts between private parties (private contracts), not those between the state and private parties (public contracts).<sup>16</sup> A proponent of this theory is Justice Brennan, who stated in a dissent that:

The Framers of our Constitution conceived of the Contract Clause primarily as protection for economic transactions entered into by purely private parties, rather than obligations involving the State

itself. The Framers fully recognized that nothing would so jeopardize the legitimacy of a system of government that relies upon the ebbs and flows of politics to "clean out the rascals" than the possibility that those same rascals might perpetuate their policies simply by locking them into binding contracts.<sup>17</sup>

### Early decisions

In early decisions, the U.S. Supreme Court declined to limit the federal contract clause to apply only to debtor relief laws or private contracts. For example, in *Fletcher v. Peck*,<sup>18</sup> the contract at issue was a land grant by the Georgia legislature. After one of the grantees resold the land to a purchaser, a scandal ensued when the public learned that bribery had motivated the legislature to make the grants. In response to the scandal, the Georgia legislature rescinded the grants. The purchaser argued that the rescission did not affect his title to the land. The U.S. Supreme Court agreed and held that the legislature's rescission unconstitutionally impaired the original grant. In its opinion, the Court refused to exempt contracts made by a state from the federal contract clause.<sup>19</sup> Likewise, in *Trustees of Dartmouth College v. Woodward*,<sup>20</sup> the U.S. Supreme Court held that salary contracts between the state and public officers had the same protection under the clause as private employment contracts.<sup>21</sup>

However, early U.S. Supreme Court decisions did limit the scope of the federal contract clause with respect to retroactive impairments. In *Sturges v. Crowninshield*,<sup>22</sup> when a state enacted a law discharging debts owed under contracts entered into *before* the law's enactment, the U.S. Supreme Court held that the law's retroactive application violated the clause. Subsequently, in *Ogden v. Saunders*,<sup>23</sup> the Court found no such violation and upheld a state law that discharged

11. Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHICAGO L. REV. 703, 707 (1984).

12. Douglas W. Kmiec & John O. McGinnis, *The Contracts Clause: A Return to Original Understanding*, 14 HASTINGS CONST. L.Q. 525, 526 (Spring 1987).

13. See, e.g., RONALD D. ROTUNDA & JOHN E. NOWAK, 2 TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 15.8 (b), at 879–80 (5th ed. 2012) and WILLIAM J. RICH, 1 MODERN CONSTITUTIONAL LAW: LIBERTY AND EQUALITY § 17:26, at 688 (3rd ed. 2011).

14. The historical context of those laws is described in the dissenting opinion in *Home Building and Loan Association v. Blaisdell*, 290 U.S. 398, 454–58 (1934).

15. Rotunda & Nowak, *supra* note 13 at 880.

16. See Thomas W. Merrill, *Public Contracts, Private Contracts, and the Transformation of the Constitutional Order*, 37 CASE W. RES. L. REV. 597, 600 (1987).

17. *United States Trust Co. v. New Jersey*, 431 U.S. 1, 45 (1977) (citations omitted).

18. 10 U.S. 87 (1810).

19. *Id.* at 137–39.

20. 17 U.S. 518 (1819).

21. *Id.* at 694.

22. 17 U.S. 122 (1819).

23. 25 U.S. 213 (1827).

debts under contracts entered into *after* the law's enactment. According to a dissenting opinion in *Ogden*, the rationale for that finding is that "contracts are deemed to be made in reference to the existing laws, and to be governed, regulated, and controlled" by those existing laws.<sup>24</sup> Under that rationale, if a contract is entered into after a law is enacted, the contract is deemed to incorporate that law, and the law cannot impair the contract.

The decisions described above established the general principle that the federal contract clause protects private and public contracts from retroactive impairments. However, it was not until the twentieth century that the U.S. Supreme Court developed a detailed test for applying that principle on a case-by-case basis. Why the delay? The answer may be found in the Due Process Clause of the Fourteenth Amendment, which was ratified after the Civil War.<sup>25</sup> That clause prohibits states from depriving any person of life, liberty, or property without due process of law, and has been interpreted to have both procedural and substantive protections. For procedural due process, courts ask whether the state followed proper procedures when making a deprivation and, for substantive due process, courts ask whether the state had a sufficient substantive justification for the deprivation. Some scholars have argued that, following ratification of the Fourteenth Amendment, the U.S. Supreme Court began to rely on substantive due process, rather than the federal contract clause, to void state laws that infringed on property or business interests.<sup>26</sup> Although the Court frequently relied on substantive due process through the early twentieth century to protect those interests, the Court repudiated that approach as the Great Depression ended.

### Developing a test

When a state passed debtor relief legislation in response to the Great Depression, the U.S. Supreme Court took

the first step in developing a detailed test for the federal contract clause. In 1933, Minnesota enacted a law that, for a limited period, gave borrowers additional time to buy back foreclosure properties. When a lender argued that the law unconstitutionally impaired a preexisting mortgage, the Court announced a five-part test and upheld the law in *Home Building and Loan Association v. Blaisdell*.<sup>27</sup> Under that test, a state law that retroactively impairs a contract does not violate the federal contract clause if all of the following are satisfied: 1) the law was enacted during an emergency; 2) its purpose was to protect a basic interest of society rather than to advantage particular individuals; 3) the relief granted is appropriate to the emergency; 4) the impairment is reasonable; and 5) the law is in effect only during the emergency.<sup>28</sup>

In 1977, the U.S. Supreme Court formulated a different test in *United States Trust Co. v. New Jersey*.<sup>29</sup> New Jersey enacted a statutory covenant in 1962 that limited the ability of a port authority to subsidize rail passenger transportation from revenues that were pledged as security to the authority's bondholders. In response to the energy crisis of the early 1970s, as well as concerns about air pollution, New Jersey repealed the covenant in 1974 in order to allow the port authority to subsidize mass transit to a greater extent. The bondholders argued that the repeal unconstitutionally impaired their contracts by reducing the financial security of their bonds. The Court agreed with the bondholders after applying the following test: if a state law impairs a contract, the impairment is constitutional if it is reasonable and necessary to support an important public purpose.<sup>30</sup> In addition, when the state attempts to relieve itself of an obligation under a public contract, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake."<sup>31</sup>

In *United States Trust Co.*, the Court viewed the statutory covenant as a contractual obligation of the state.<sup>32</sup>

24. *Ogden*, 25 U.S. at 295–96.

25. Although the Fifth Amendment, which was ratified with the Bill of Rights in 1791, contains a similar Due Process Clause, the U.S. Supreme Court held that the Fifth Amendment's clause applies to the federal government, not the states. *Barron v. City of Baltimore*, 32 U.S. 243, 250–51 (1833). As a result, states were not subject to due process under the U.S. Constitution until the ratification of the Fourteenth Amendment in 1868.

26. Rotunda & Nowak, *supra* note 13 at 886–87.

27. 290 U.S. 398 (1934).

28. *Id.* at 444–47.

29. 431 U.S. 1 (1977).

30. *Id.* at 25.

31. *Id.* at 26.

32. *Id.* at 18.

Owing less deference to the state, the Court found that the impairment was not reasonable. According to the Court, an impairment is reasonable when induced by unforeseen circumstances. Because the need for mass transit was foreseeable when the state enacted the covenant, the state could not reasonably rely on that need to justify repealing the covenant.<sup>33</sup> In addition, the Court found that the repeal was not necessary, as the state could have accomplished its public policy goals regarding mass transit and air pollution by less drastic means.<sup>34</sup>

One year after its decision in *United States Trust Co.*, the U.S. Supreme Court returned to the *Blaisdell* test to consider a state law impairing private pension contracts. Minnesota had enacted a law that applied to companies who closed plants in the state. The law made employees of those companies eligible for pension benefits, even if they were not eligible for the benefits under their companies' preexisting pension plans. In *Allied Structural Steel Co. v. Spannaus*,<sup>35</sup> the Court found that the law failed the *Blaisdell* test. According to the Court, among the law's failures were that it was not enacted to deal with an emergency and it affected only a limited number of employees instead of a basic societal interest.<sup>36</sup>

### The current test

In 1983, the U.S. Supreme Court relied on *Blaisdell* and *United States Trust Co.* to establish the three-part test that is followed today. In *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*,<sup>37</sup> Kansas enacted a law establishing price controls for a period of almost seven years on natural gas sold under contracts executed before the law's enactment. The Court upheld the law under the following test. First, a court must find that the state law substantially impairs a contract. If the contract was formed in an industry that was subject to past regulation, a court is less likely to find an impairment to be substantial. Also, the more severe the impair-

ment, the more closely a court will scrutinize the law.<sup>38</sup> Second, if there is a substantial impairment, the state must have a "significant and legitimate public purpose" for the impairment.<sup>39</sup> Without such a purpose, the law violates the federal contract clause. Finally, if there is such a purpose, there is no violation if the impairment "[is based] upon reasonable conditions and [is] of a character appropriate" to that purpose.<sup>40</sup>

In *Energy Reserves Group, Inc.*, the Court did not have to proceed past the first part of the test. Because natural gas prices were heavily regulated, the parties to a sales contract should have reasonably expected price controls and, therefore, the law did not impair those reasonable expectations.<sup>41</sup> Although not necessary, the Court continued its analysis and found that the law also satisfied the rest of the test.<sup>42</sup>

## The Wisconsin contract clause

When interpreting the state contract clause, the Wisconsin Supreme Court has stated that, although it is not bound by the U.S. Supreme Court's decisions regarding the federal contract clause, it relies on those decisions for guidance.<sup>43</sup> As a result, Wisconsin courts currently follow the three-part test established in *Energy Reserves Group, Inc.*<sup>44</sup> Like the U.S. Supreme Court in that decision, some Wisconsin courts phrase the third part of the test as determining whether an impairment "[is based] upon reasonable conditions and [is] of a character appropriate" to a law's purpose.<sup>45</sup> Other courts determine whether an impairment is "reasonable and necessary" for a law's purpose.<sup>46</sup> Under either phrasing,

33. *United States Trust Co.*, 431 U.S. at 31–32.

34. *Id.* at 29–31.

35. 438 U.S. 234 (1978).

36. *Id.* at 248–50.

37. 459 U.S. 400 (1983).

38. *Id.* at 411.

39. *Id.*

40. *Id.* at 412.

41. *Id.* at 416.

42. *Id.* at 416–19.

43. *Madison Teachers, Inc. v. Walker*, 2014 WI 99, ¶ 133, n.45, 358 Wis. 2d 1, 851 N.W.2d 337 (citing *Chappy v. Labor & Industry Review Commission*, 136 Wis. 2d 172, 186, 401 N.W.2d 568 (1987)).

44. See, e.g., *Metropolitan Milwaukee Association of Commerce, Inc. v. City of Milwaukee*, 2011 WI App 45, ¶ 98, 332 Wis. 2d 459, 798 N.W.2d 287.

45. See *Pfister v. Milwaukee Economic Development Corp.*, 216 Wis. 2d 243, 261, 576 N.W.2d 554 (Ct. App. 1998).

46. See *Dairyland Greyhound Park, Inc. v. Doyle*, 2006 WI 107, ¶ 57, 295 Wis. 2d 1, 719 N.W.2d 408.

a state law violates the state contract clause under the third part of the test if there is not an adequate relationship between an impairment and a law's purpose.

### **Substantial impairment**

Under the first part of the test, Wisconsin courts consider whether a law substantially impairs a contract. In *Madison Teachers, Inc. v. Walker*, the Wisconsin Supreme Court divided that part of the test into the following components: "1) whether there is a contractual relationship, 2) whether a change in law impairs that contractual relationship, and 3) whether the impairment is substantial."<sup>47</sup> In that case, the court did not have to proceed past the first component in upholding a state law that significantly changed public employee labor laws. The law's changes included prohibiting the City of Milwaukee from paying its employees' share of their contributions to a retirement system. A labor organization representing city employees argued that the city was contractually obligated to pay the employee contributions under the city ordinance that established the retirement system. According to the labor organization, the law unconstitutionally impaired that contractual obligation. The Wisconsin Supreme Court disagreed. After doing what the court called a "close reading" of the ordinance, the court concluded that, although the ordinance did create contractual rights to retirement benefits, the ordinance did not create contractual rights to the city's contributions.<sup>48</sup> As a result, there was no contractual relationship for the law to impair.

Regarding the second component, Wisconsin courts consider the expectations of the parties when entering into a contract. As explained by the Wisconsin Court of Appeals in *Pfister v. Milwaukee Economic Development Corp.*, impairment occurs when a state law alters those expectations or imposes an obligation on a party "beyond the obligations the party had agreed to undertake."<sup>49</sup> At issue in that case was the legislature's amendment of the wage lien law. Prior to amendment, if an individual claimed an employer owed him or her wages, the law required a state agency to obtain a wage

lien against the employer and gave that lien priority over most other preexisting liens against the employer. As amended, the law allowed either the individual or the state agency to obtain the wage lien. An individual obtained a lien against an employer under the amendment and asserted the lien's priority over a preexisting lien that a lender obtained under a contract with the employer. Because the lender entered into the contract before enactment of the amendment, the lender argued that the amendment impaired the contract. The court of appeals disagreed. According to the court, when entering into the contract, the lender was aware of the potential for a wage lien to take priority over the lender's lien. The amendment's allowance of the individual, in addition to the state agency, to obtain a wage lien did not sufficiently alter the lender's expectations.<sup>50</sup>

For the third component, if a law does impair a contract, the Wisconsin Supreme Court has refused to speculate on whether the impairment is substantial. Instead, the court must be shown that the impairment is substantial. For example, in *Chappy v. Labor & Industry Review Commission*,<sup>51</sup> a state law increased worker's compensation benefits for certain injuries that occurred before the law's enactment. A worker's compensation insurer argued that the premiums it had received under a preexisting contract with a company did not adequately compensate the insurer for paying increased benefits to an employee of the company. Although the Wisconsin Supreme Court agreed that the increase in benefits did impair the contract, the court could not find that the impairment was substantial because the insurer failed to provide any information on the magnitude of its increased costs, and the court refused to speculate.<sup>52</sup>

### **Significant and legitimate public purpose**

If a state law substantially impairs a contract under the first part of the test, that impairment is unconstitutional if the state law fails to satisfy the second or third parts

47. 2014 WI 99 at ¶¶ 134–36.

48. *Id.* at ¶ 150.

49. 216 Wis. 2d at 261.

50. *Id.* at 261–62.

51. 136 Wis. 2d 172, 401 N.W.2d 568 (1987).

52. *Chappy*, 136 Wis. 2d at 189. Even though the impairment was not substantial, the court further analyzed the law under the second and third parts of the test and concluded that the law did not violate the state or federal contract clauses. *Id.* at 189–91.

of the test. The second part requires the law to have a significant and legitimate public purpose. However, the Wisconsin Supreme Court has warned that courts should “not be asked to speculate or conjure up possible explanations” to satisfy the second part of the test.<sup>53</sup> If the purpose of a law is not clear to a court, the law likely will not satisfy the second part of the test.

For example, in *Society Insurance v. Labor & Industry Review Commission*,<sup>54</sup> a state law failed to satisfy the second part of the test. In that case, an insurer contracted with an employer to pay worker’s compensation benefits to injured employees. When the contract was executed, a state law imposed a 12-year statute of limitations on the insurer’s liability under such contracts. For 12 years after an injury, the law required the insurer to pay the benefits. After 12 years, the insurer was not liable and injured employees could obtain payments from a state fund called the Work Injury Supplemental Benefit Fund. After the contract was executed, the legislature enacted a law retroactively suspending the statute of limitations, which made the insurer liable for all payments regardless of the date of an injury.

When the insurer challenged the law, the Wisconsin Supreme Court found a substantial impairment in the law’s modification of the insurer’s liability under the contract. That modification exposed the insurer to unexpected and potentially significant financial losses. As for the purpose of the law, the state argued that the law was intended to preserve the solvency of the state fund. However, the court found nothing in the legislative drafting file or the case record that suggested that the fund was insolvent or that the law would affect solvency.<sup>55</sup> As a result, the court found that the law failed to satisfy the second part of the test.<sup>56</sup>

The Wisconsin Supreme Court reached a similar result in two earlier decisions, *Wipperfurth v. U-Haul Co. of Western Wisconsin, Inc.* and *State ex rel. Building Owners and Managers Association v. Adamany*.<sup>57</sup> In *Wipperfurth*, the parties had entered into a dealership agreement several years before the legislature enacted a dealership law. In enacting the law, the legislature included a provision specifying that the law applied prospectively to agreements entered into after the law’s enactment. However, the legislature subsequently repealed that provision and provided that the law retroactively applied to all dealerships “to the full extent consistent with the constitutions of this state and the United States.”<sup>58</sup> When one of the parties terminated the agreement without complying with the law, the other party claimed the termination was not effective.

The Wisconsin Supreme Court agreed with the terminating party that retroactive application violated the state contract clause. The law failed the second part of the test, as there was “no showing that the severe disruption of the contractual expectation of [the] parties was necessary to meet an important social problem.”<sup>59</sup> The court criticized the law’s language regarding the state and U.S. constitutions as “equivocating,” saying the language failed to demonstrate any legislative determination of the necessity for retroactive application.<sup>60</sup>

In *Adamany*, a state law required rental property owners to reduce rents in proportion to the amount their property taxes were reduced in the previous year. According to the Wisconsin Supreme Court, it was “not clear from the face of the law what interest is sought to be protected and how the [law] would serve to protect that interest.”<sup>61</sup> Because the legislature did not show the “vital purpose” that was served by “depriving the owners here of the rent for which they bargained,” the court found that the law was unconstitutional under the second part of the test.<sup>62</sup>

The unwillingness to speculate in the above deci-

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53. *Wipperfurth v. U-Haul Co. of Western Wisconsin, Inc.*, 101 Wis. 2d 586, 598, 304 N.W.2d 767 (1981) (quoting *State ex rel. Building Owners and Managers Association v. Adamany*, 64 Wis. 2d 280, 303, 304 N.W.2d 767 (1974)).

54. 2010 WI 68, 326 Wis. 2d 444, 786 N.W.2d 385.

55. *Society Insurance*, 2010 WI 68 at ¶ 50. Although not mentioned by the court, the law itself did not contain a statement of legislative purpose or intent.

56. The court could not find a rational purpose justifying the law when the court analyzed the insurer’s separate claim that the law violated substantive due process. Because there was no rational purpose, the court explained that it necessarily had to conclude that there was no significant and legitimate public purpose. *Id.*

57. 64 Wis. 2d 280, 219 N.W.2d 274 (1974).

58. Wis. STAT. § 135.025 (2) (d).

59. *Wipperfurth*, 101 Wis. 2d at 598.

60. *Id.*

61. 64 Wis. 2d at 294.

62. *Id.* at 302.



sions seems at odds with the standard of review Wisconsin courts usually apply to challenges to a law's constitutionality. Under that standard, there is a strong presumption of constitutionality, and a challenger must show beyond a reasonable doubt that a law is unconstitutional.<sup>63</sup> According to the Wisconsin Supreme Court, "[i]f there is any reasonable basis upon which . . . legislation may constitutionally rest, the court must assume that the legislature had such fact in mind and passed the act pursuant thereto."<sup>64</sup> Why then, for example, didn't the court assume the legislature was concerned about the solvency of the Work Injury Supplemental Benefit Fund in *Society Insurance*? The explanation may be that it requires more proof to establish a significant and legitimate public purpose for a law than it does to establish a reasonable basis. When more proof is needed, courts may be reluctant to rely on assumptions or speculation.

### Relationship between impairment and purpose

The third part of the test analyzes the relationship between the impairment and its purpose. In doing that analysis, Wisconsin courts follow the U.S. Supreme Court's lead in *United States Trust Co.* and use different standards of review for private and public contracts. For laws impairing private contracts, the Wisconsin Supreme Court has directed that "courts should defer to the legislature's judgment as to the necessity and reasonableness" of the law.<sup>65</sup> However, deference is not absolute, and courts must determine whether a law is "carefully drawn" to show that the impairment is necessary and serves the purpose found under the second part of the test.<sup>66</sup>

For example, in *Overlook Farms v. Alternative Living*,<sup>67</sup> the Wisconsin Court of Appeals upheld a law that allowed for the placement of group homes in residential areas, even in those areas subject to restrictive

covenants prohibiting group homes.<sup>68</sup> The law contained the following statement of legislative purpose, which the court found to be significant and legitimate: "to promote public health, safety, and welfare by enabling persons who otherwise would be institutionalized to live in normal residential settings."<sup>69</sup> Based on the law's regulation of the location and operation of the group homes, the court found that the law was "properly tailored" to fulfill its purpose.<sup>70</sup> Therefore, the law's substantial impairment of restrictive covenants did not violate the state contract clause.

For public contracts, less deference is owed to the legislature. As explained by the Wisconsin Supreme Court in *Dairyland Greyhound Park, Inc. v. Doyle*, because the state's self-interest is at stake when the legislature impairs a contract to which the state is a party, courts use heightened scrutiny to evaluate the legislature's determination that the impairment is reasonable and necessary.<sup>71</sup>

In *Dairyland*, the court held that a 1993 state constitutional amendment prohibiting certain types of gambling did not retroactively apply to preexisting gaming compacts between the state and Indian tribes. The compacts provided that they would automatically renew unless the governor or the tribes exercised a nonrenewal option. A business that competed with tribal casinos argued that the amendment prohibited renewal of the compacts and therefore required the governor to exercise the nonrenewal option. The court held that such application of the amendment would violate the federal and state contract clauses.

Under the first part of the test, the court found that requiring nonrenewal would force the state to renegotiate the compacts, which would "severely impair, indeed eliminate," the state's contractual rights under the compacts.<sup>72</sup> Under the second part of the test, the

63. See, e.g., *Chappy*, 136 Wis. 2d at 184–85.

64. *Id.* at 185.

65. *Id.* at 190.

66. *Adamany*, 64 Wis. 2d at 303.

67. 143 Wis. 2d 485, 422 N.W.2d 131 (Ct. App. 1988).

68. A restrictive covenant is a contract between a grantor and grantee of land that restricts the grantee's use and occupancy of the land. *Restrictive Covenant*, BLACK'S LAW DICTIONARY (6th ed. 1990).

69. *Overlook Farms*, 143 Wis. 2d at 497 (quoting 1977 Wis. Sess. Laws, ch. 205, § 1).

70. *Id.* at 499.

71. 2006 WI 107 at ¶ 71. The case is unique because it involved impairment by a constitutional amendment as opposed to statutory law.

72. *Id.* at ¶¶ 69–70.

court recognized that the regulation of gambling was a legitimate public purpose.<sup>73</sup> However, under the third part of the test, the court found that impairment of the compacts was not reasonable for two reasons. First, when the state and tribes negotiated the compacts, it was not foreseeable that the constitutional amendment would invalidate their renewal provisions. Second, no substantial change in conditions justified the impairment.<sup>74</sup>

In *Dairyland*, the Wisconsin Supreme Court used the severity of the impairment to justify its use of heightened scrutiny, in addition to the fact that the state was a party to the compacts.<sup>75</sup> As explained by the court in an earlier decision, *State ex rel. Cannon v. Moran*,<sup>76</sup> the “degree of impairment determines the level of scrutiny.”<sup>77</sup> In that earlier decision, the legislature had enacted a law that converted county courts to state circuit courts. The law allowed some county judges who continued to serve as circuit court judges to receive retirement benefits paid by the county at the same time that they received salaries paid by the state. Two years later, the legislature enacted a second law that reduced the judges’ state-paid salaries by the amount of their county-paid retirement benefits. The second law stated that one of its purposes was “to restore public confidence in civil servants by discouraging and ameliorating the practice of public employees accepting retirement benefits . . . while receiving an adequate salary.”<sup>78</sup>

The court found that the reduction in salaries effectively reduced the retirement benefits, which substantially impaired the judges’ contractual rights to those benefits. Because the reduction was unexpected and substantial, the court found the impairment to be severe. Under heightened scrutiny, the court found that, because the impairment applied to a limited number of public employees, it did “little to protect the broad societal interests articulated in the legislative purpose.”<sup>79</sup>

Therefore, the impairment was neither reasonable nor appropriate to the law’s purpose.

## Conclusion

Like the federal contract clause, the actual language of the state contract clause is not limited to only those impairments that are retroactive or substantial. It does not distinguish between public and private contracts. It specifies no test regarding the purpose, reasonableness, appropriateness, or necessity of an impairment. The language is plain and broad: the legislature may not pass any law impairing the obligation of contracts. So why don’t courts interpret the state or federal contract clause literally to prohibit any impairment by the state? The reason is that courts consider the state’s inherent power to promote public welfare to be “paramount” to private rights under contracts.<sup>80</sup> According to the Wisconsin Supreme Court, the state contract clause must be “accommodated” to that power.<sup>81</sup> Wisconsin courts make that accommodation by using the test described above to determine, one case at a time, when the power of the state should prevail over private rights. ■

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73. *Dairyland*, 2006 WI 107 at ¶ 74.

74. *Id.* at ¶¶ 75–79.

75. *Id.* at ¶ 71.

76. 111 Wis. 2d 544, 331 N.W.2d 369 (1983).

77. 111 Wis. 2d at 558.

78. *Id.* at 551 (quoting 1979 Wis. Sess. Laws, ch. 38, § 1).

79. *Id.* at 562.

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80. *Chappy*, 136 Wis. 2d at 187.

81. *Id.* at 186 (citing *Energy Reserves Group, Inc.*, 459 U.S. at 410).