

2011

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### Recommended Citation

Stephen F. Befort, *Unilateral Alteration of Public Sector Collective Bargaining Agreements and the Contract Clause*, 59 BUFF. L. REV. 1 (2011), available at [https://scholarship.law.umn.edu/faculty\\_articles/24](https://scholarship.law.umn.edu/faculty_articles/24).

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# BUFFALO LAW REVIEW

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VOLUME 59

JANUARY 2011

NUMBER 1

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## Unilateral Alteration of Public Sector Collective Bargaining Agreements and the Contract Clause

STEPHEN F. BEFORT†

### INTRODUCTION

Public sector budgets in the United States have experienced a roller coaster ride during the past three decades. Rapidly changing economic conditions have produced alternating periods of feast and famine for state and local governmental units. With personnel costs typically constituting over half of all expenditures,<sup>1</sup> public employers increasingly have focused on reducing the cost of employment as a means of coping with periods of fiscal crisis.

In the highly unionized public sector,<sup>2</sup> managerial attempts to rein in personnel costs have put stress on the collective bargaining process. Not surprisingly, many public employers adopted aggressive positions at the bargaining table as a means of coping with fiscal strains.<sup>3</sup> Sometimes, however, governmental entities took more drastic measures

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1. See *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1020 (4th Cir. 1993) (stating that personnel costs amounted to 82.5% of the Baltimore Public School budget); Clyde Summers, *Bargaining in the Government's Business: Principles and Politics*, 18 U. TOL. L. REV. 265, 266 (1987) ("Labor costs may be [70%] of a city's budget.").

2. See *infra* note 19 and accompanying text.

3. See Donald Slesnick II & Jennifer Poltrock, *Public Sector Bargaining in the Mid-90s (The 1980s Were Challenging, But This is Ridiculous)—A Union Perspective*, 25 J. L. & EDUC. 661, 662-64 (1996).

such as attempting to modify existing contractual agreements on a unilateral basis.<sup>4</sup> In the private sector, such unilateral action would be deemed both a breach of contract remediable in arbitration and an unfair labor practice subject to the jurisdiction of the National Labor Relations Board (“NLRB”). Although similar limitations also exist in most public sector jurisdictions, governmental bodies generally have more leeway to act on a unilateral basis than do their private sector counterparts.<sup>5</sup>

This Article focuses on one source of governmental unilateral action—the law-making function. This occurs when a governmental entity with law-making authority, such as a state legislature, enacts a statute or ordinance that trumps the terms of a collective bargaining agreement. If that entity is not a statutory “employer” who is a signatory party to the agreement, the only limitation on the entity’s lawmaking authority is the contract clause of the United States Constitution.<sup>6</sup> Although the contract clause literally proscribes any impairment of contract, the United States Supreme Court has long recognized that a state may modify a contract by legislation that is “reasonable and necessary to serve an important public purpose.”<sup>7</sup> This justification is more problematic, however, when a legislative body impairs one of its own contracts with the effect of relieving its own financial obligations.

This Article analyzes those judicial decisions that have confronted the rub between public sector collective bargaining agreements and a governmental body’s law-making function. A majority of decisions have appropriately applied Supreme Court precedent to restrict the scope of such legislative modifications to instances where they are reasonable and necessary. A minority of decisions, however, have deferred to the legislative body in spite of that entity’s self-interest. One objective of this Article is to determine whether this latter group of decisions inappropriately

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4. *See id.* at 667.

5. *See* Stephen F. Befort, *Public Sector Bargaining: Fiscal Crisis and Unilateral Change*, 69 MINN. L. REV. 1221, 1274 (1985) [hereinafter Befort, *Public Sector Bargaining*].

6. U.S. CONST. art. I, § 10, cl. 1 (“No [s]tate shall . . . pass any . . . [l]aw impairing the [o]bligation of [c]ontracts . . .”).

7. *U. S. Trust Co. v. New Jersey*, 431 U.S. 1, 25 (1977).

affords second-class status to public sector employees and their collective agreements.

The Article proceeds in five parts. Part I discusses the growth of public sector unionism and some of the conceptual theories that initially delayed this growth. Part II reviews the cyclical budgetary problems that have beset the public sector over the past thirty years. Part III then compares and contrasts unilateral change rules in the private and public sectors. In Part IV, the Article examines the contract clause jurisprudence that has emerged with respect to public sector collective bargaining agreements through these successive waves of fiscal crisis. Finally, in Part V, the Article critiques this jurisprudence and suggests a framework for the resolution of future disputes.

### I. THE BELATED GROWTH OF PUBLIC SECTOR UNIONISM

Although public sector unions first emerged in the 1800s,<sup>8</sup> their numbers lagged far behind that of private sector unions through the 1950s.<sup>9</sup> When Congress enacted the National Labor Relations Act (“NLRA”) in 1935, governmental employers were excluded from the scope of coverage.<sup>10</sup> While this exclusion reflected concerns about federalism and the Tenth Amendment generally,<sup>11</sup> it also reflected the then-pervasive belief that public employment and union membership were inherently incompatible. In 1937, President Franklin D. Roosevelt expressed the prevailing sentiment of the period in a letter to the President of the National Federation of Federal Employees stating:

All [g]overnment employees should realize that the process of collective bargaining, as usually understood, cannot be transplanted into the public service. It has its distinct and

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8. See JOSEPH R. GRODIN ET AL., PUBLIC SECTOR EMPLOYMENT: CASES AND MATERIALS 4-5 (2004).

9. See Richard B. Freeman, *Through Public Sector Eyes: Employee Attitudes Toward Public Sector Labor Relations in the U.S.*, in PUBLIC SECTOR EMPLOYMENT IN A TIME OF TRANSITION 59, 59 (Dale Belman et al. eds., 1996).

10. See 29 U.S.C. § 152(2) (2006).

11. See Joseph E. Slater, *The Court Does Not Know “What a Labor Union Is”:* *How State Structures and Judicial (Mis)constructions Deformed Public Sector Labor Law*, 79 OR. L. REV. 981, 1025-27 (2000).

insurmountable limitations when applied to public personnel management. The very nature and purposes of [g]overnment make it impossible for administrative officials to represent fully or to bind the employer in mutual discussions with [g]overnment employe [sic] organizations. The employer is the whole people, who speak by means of laws enacted by their representatives in Congress. Accordingly, administrative officials and employes [sic] alike are governed and guided, and in many instances restricted, by laws which establish policies, procedures, or rules in personnel matters.<sup>12</sup>

The courts tended to share this unfavorable view of public sector unionism, and decisions upholding restrictions on the right of public employees to join unions were commonplace through the early 1960s.<sup>13</sup>

During this period, two conceptual distinctions were thought to preclude the possibility of transplanting private sector policies and procedures to the public sector.<sup>14</sup> First, emanating from the old English common law notion that the "king can do no wrong," the sovereignty doctrine taught that the state, as the supreme repository of all legal and political authority, could not be compelled to accept an obligation against its will.<sup>15</sup> The doctrine also implied that public

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12. Letter from President Franklin D. Roosevelt to Luther C. Steward, President, Nat'l Fed'n of Fed. Emps. (Aug. 16, 1937), reprinted in CHARLES S. RHYNE, *LABOR UNIONS AND MUNICIPAL EMPLOYEE LAW* 436-37 (1946).

13. See, e.g., *Perez v. Board of Police Comm'rs*, 178 P.2d 537, 545 (Cal. Dist. Ct. App. 1947); *Mugford v. Mayor of Balt.*, 44 A.2d 745, 747 (Md. 1945); *Local 201, AFSCME v. City of Muskegon*, 120 N.W.2d 197, 197 (Mich. 1963); *City of Springfield v. Clouse*, 206 S.W.2d 539, 545 (Mo. 1947); *Hagerman v. City of Dayton*, 71 N.E.2d 246, 254 (Ohio 1947).

14. See generally HARRY H. WELLINGTON & RALPH K. WINTER, JR., *THE UNIONS AND THE CITIES* 7-32 (1971); William L. Corbett, *Determining the Scope of Public Sector Collective Bargaining: A New Look Via a Balancing Formula*, 40 MONT. L. REV. 231, 253-57 (1979); William J. Kilberg, *Appropriate Subjects for Bargaining in Local Government Labor Relations*, 30 MD. L. REV. 179, 184-91 (1970); Sylvester Petro, *Sovereignty and Compulsory Public-Sector Bargaining*, 10 WAKE FOREST L. REV. 25, 165 (1974). But see Clyde W. Summers, *Public Employee Bargaining: A Political Perspective*, 83 YALE L.J. 1156, 1156-57 (1974) ("[I]t does not follow from the proposition that collective bargaining in the public and private sectors is different . . . that practices in the private sector cannot be transplanted to the public sector.").

15. KURT L. HANSLOWE, *THE EMERGING LAW OF LABOR RELATIONS IN PUBLIC EMPLOYMENT* 14-20 (1967); JOAN WEITZMAN, *THE SCOPE OF BARGAINING IN PUBLIC EMPLOYMENT* 7-12 (1975).

employees, as servants of the sovereign, owed a duty of “extra loyalty” to the state.<sup>16</sup> A related barrier to the development of public sector collective bargaining was the delegation doctrine, which prohibits government from delegating to private parties authority concerning matters properly within its legislative discretion.<sup>17</sup> Collective negotiation with a public sector union ran afoul of this doctrine because it was viewed as an improper delegation, or abdication, of governmental authority to labor unions.<sup>18</sup>

Sometime around 1960, the respective fortunes of unions in the private and public sectors began to reverse. Private sector union density began a long decline from its peak of around 40%, while public sector union density began to climb from its trough of around 5%.<sup>19</sup> Public sector unionism’s growth spurt coincided with an extraordinary rise in public sector budgets.<sup>20</sup> Fueled by a strong economy and President Johnson’s War on Poverty, state and local government expenditures increased from 8.4% of gross national product in 1957 to 13.2% in 1977.<sup>21</sup> The public

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16. See Harry T. Edwards, *The Developing Labor Relations Law in the Public Sector*, 10 DUQ. L. REV. 357, 360-61 (1972); Allan Weisenfeld, *Public Employees—First or Second Class Citizens*, 16 LAB. L.J. 685, 686-87 (1965).

17. See 1 KENNETH CULP DAVIS, *ADMINISTRATIVE LAW TREATISE* § 3.12 (2d ed. 1978).

18. See Slater, *supra* note 11, at 996, 1000-04.

19. See Freeman, *supra* note 9, at 59. As has been well-documented, union membership in the United States peaked at 34.5% of the workforce in 1954 and since has experienced a long and continuous decline. See Stephen F. Befort, *Labor and Employment Law at the Millennium: A Historical Review and Critical Assessment*, 43 B.C. L. REV. 351, 361-62 (2002); Michael Goldfield, *The Decline of Organized Labor in the United States* 10 tbl.1 (1987).

20. The coincidental growth of government employment and public sector unionism is described in a number of articles. See, e.g., Patricia N. Blair, *State Legislative Control Over the Conditions of Public Employment: Defining the Scope of Collective Bargaining for State and Municipal Employees*, 26 VAND. L. REV. 1, 5-7 (1973); Joan P. Weitzman, *The Effect of Economic Restraints on Public-Sector Collective Bargaining: The Lessons of New York City*, 2 EMP. REL. L.J. 286, 288 (1977).

21. RESEARCH & POL’Y COMM. OF THE COMM. FOR ECON. DEV., *IMPROVING MANAGEMENT OF THE PUBLIC WORK FORCE: THE CHALLENGE TO STATE AND LOCAL GOVERNMENT* 29 (1978).

sector labor force followed suit, almost doubling in size between 1960 and 1980.<sup>22</sup>

Public sector unionization rates increased even more dramatically. In 1956, only 915,000 federal, state, and local employees were union members.<sup>23</sup> By 1980, the number of state and local employees that belonged to employee organizations had increased more than five-fold to 5,030,564 employees.<sup>24</sup> Meanwhile, a majority of states adopted legislation guaranteeing the collective bargaining rights of some or all occupational groups.<sup>25</sup>

Today, union density rates in the private and public sectors are virtually the inverse of what they were in 1960. On a national level, union members accounted for 12.4% of employed wage and salary workers in 2008.<sup>26</sup> But, public sector employees were over four times more likely to be members of a union (40.7%) than were employees in private industry (8.4%).<sup>27</sup>

As government's role in society expanded, the overarching concept of absolute governmental supremacy began to wane.<sup>28</sup> Government began to assume more ordinary legal responsibilities in its relationship with the public, and the paternalistic "extra loyalty" doctrine

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22. The public sector labor force increased from 8,353,000 in 1960 to 16,241,000 in 1980. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, 31 EMP. & EARNINGS 1, 45 tbl.B-1 (Feb. 1984).

23. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, HANDBOOK OF LABOR STATISTICS 1975, BULL. 1865, 382 tbl.155 (1975).

24. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE & LABOR-MGMT. SERVS. ADMIN., U.S. DEP'T OF LABOR, STATE AND LOCAL GOVERNMENT SPECIAL STUDIES NO. 102, LABOR-MANAGEMENT RELATIONS IN STATE AND LOCAL GOVERNMENTS: 1980, 1 tbl.B (1981).

25. By 1977, thirty-three states had enacted collective bargaining legislation that covered some or all public sector occupational groups. B. V. H. Schneider, *Public-Sector Labor Legislation—An Evolutionary Analysis*, in PUBLIC-SECTOR BARGAINING 191, 192 (Benjamin Aaron et al. eds., 1979).

26. Bureau of Labor Statistics, U.S. Dep't of Labor, Economic News Release, *Union Membership (Annual) News Release*, tbl.1, <http://www.bls.gov/news.release/union2.htm> (last modified Jan. 22, 2010).

27. *Id.* at tbl. 3.

28. See WEITZMAN, *supra* note 15, at 8-12; WELLINGTON & WINTER, *supra* note 14, at 36-41.

declined in importance.<sup>29</sup> This trend is perhaps best illustrated by the widespread abrogation of sovereign immunity with respect to tort claims.<sup>30</sup>

The enactment of comprehensive bargaining laws and the decline of the sovereignty doctrine did not, however, result in a wholesale transplant of the private sector labor relations model to the public sector. Courts and commentators, instead, formulated a new set of theoretical constraints that, although no longer foreclosing public sector bargaining in its entirety, purportedly require a more limited scope of bargaining and a ban on the right to strike.<sup>31</sup>

These modern constraints on the bargaining obligation are a result of both the structural complexity of government and the demands of the democratic political process.<sup>32</sup> The structural obstacles in the public sector stem from the coexistence of public employee bargaining legislation with a large body of constitutional and statutory provisions that bear on the employment relationship and that, for the most part, predate the advent of public sector bargaining.<sup>33</sup> The political limitations result from the fear that adopting private sector notions regarding the scope of bargaining and contract enforcement might skew the democratic process by giving public sector unions an inordinate degree of power in comparison with other interest groups.<sup>34</sup>

Both of these concerns are relevant to the law-making function of state and local legislative bodies that is the subject of this Article. Yet, as I have written elsewhere, “the

29. See Edwards, *supra* note 16, at 359-61.

30. See *id.* at 360.

31. See, e.g., Befort, *Public Sector Bargaining*, *supra* note 5, at 1234-35.

32. See Edwards, *supra* note 16, at 361-64; William F. Kay, *The Need for Limitation Upon the Scope of Negotiations in Public Education*, II, 2 J.L. & EDUC. 155, 155 (1973).

33. See Arnold Weber, *Prospects for the Future*, Introduction to LABOR RELATIONS LAW IN THE PUBLIC SECTOR 3, 5 (Andria S. Knapp ed. 1977) (“[P]ublic sector unionism and bargaining were superimposed on a well-developed, explicit and, indeed, almost ossified alternate personnel system which went under the folkloric term, civil service.”).

34. See WELLINGTON & WINTER, *supra* note 14, at 7-32; see also Clyde Summers, *Bargaining in the Government’s Business: Principles and Politics*, 18 U. TOL. L. REV. 265, 265 (1987).



brief history of public sector labor relations is largely a story of how these theoretical distinctions have become obsolete as labor relations in the public sector increasingly has taken on the attributes of private sector labor relations.”<sup>35</sup> One of the goals of this Article is to examine the extent to which the judiciary’s treatment of the law-making function and the contract clause replicates labor relations in the private sector or continues the conceptual second-class status of public sector labor relations.

## II. CYCLES OF FISCAL CRISIS

State governments currently are “in the worst fiscal shape since the Depression.”<sup>36</sup> Governor Arnold Schwarzenegger’s “Great California Garage Sale”<sup>37</sup> symbolizes the desperate economic conditions faced by the forty-eight states that confronted a deficit in 2009.<sup>38</sup> During its two-day sale, California sold nearly 600 state-owned vehicles, office furniture, computers, electronics, jewelry, pianos, a surfboard, a food saver, and an Xbox 360 gaming system.<sup>39</sup> Despite these efforts, the state was forced to issue IOUs worth \$1.5 billion, in what some labeled a “shameful chapter in the state’s history.”<sup>40</sup> A year later, the City of Maywood, California, responded to the continuing economic downturn by laying off all 100 employees and outsourcing all municipal services.<sup>41</sup> Economic conditions deteriorated dramatically for state and local governments during 2009,<sup>42</sup> continued in 2010,<sup>43</sup> and are expected to worsen in 2011.<sup>44</sup>

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35. Befort, *Public Sector Bargaining*, *supra* note 5, at 1231-32.

36. Bob Herbert, *Invitation to Disaster*, N.Y. TIMES, Jan. 9, 2010, at A19.

37. Judy Lin, *California Hopes Garage Sale Will Put Funds into State Coffer*, BOS. GLOBE, Aug. 29, 2009, at A9.

38. *See State Budgets in Crisis: Happy New Year*, ECONOMIST, July 4, 2009, at 27.

39. Lin, *supra* note 37, at A9.

40. Matthew Yi, *State Budget Fallout: Era of IOUs is Ending, Controller Proclaims*, S.F. CHRON., Aug. 14, 2009, at D1, D7 (quoting California state Controller John Chiang).

41. *See Municipal Finances: There Goes Everybody*, ECONOMIST, July 10, 2010, at 32.

42. *See* NAT’L GOVERNORS ASS’N & NAT’L ASS’N OF STATE BUDGET OFFICERS, THE FISCAL SURVEY OF STATES, at vii-ix (June 2009) [hereinafter FISCAL SURVEY

While the severity of the 2009-10 budget crisis is relatively unique, the existence of public sector budget crises are not. The most recent crisis constitutes the fourth such period in the last thirty years. In 1982, 1991, 2003-04, and now in 2009-10, states and local government units faced similar budget problems.<sup>45</sup> During the first era in the early 1980s, more than half of the country's 275 biggest cities experienced budget problems.<sup>46</sup> During the second era in the early 1990s, a majority of the states faced severe fiscal problems.<sup>47</sup> Likewise, in fiscal year 2002, during the third

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2009], available at <http://www.nasbo.org/publications/fiscalsurvey/fiscal-survearchives/tabid/106/default.aspx> (follow "Download" hyperlink for "2009 Spring Fiscal Survey of States").

43. See NAT'L GOVERNORS ASS'N & NAT'L ASS'N OF STATE BUDGET OFFICERS, THE FISCAL SURVEY OF STATES, at vii-ix (June 2010) [hereinafter FISCAL SURVEY 2010], available at <http://www.nasbo.org/publications/fiscalsurvey/fiscal-survearchives/tabid/65/default.aspx> (follow "The Fiscal Survey of States, Spring 2010" hyperlink).

44. See Judy Keen, *States Braced to Tighten '10 Belts*, USA TODAY, Jan. 5, 2010, at 1A.

45. See FISCAL SURVEY 2010, *supra* note 43, at vii-ix; FISCAL SURVEY 2009, *supra* note 42, at vii-ix; NAT'L GOVERNORS ASS'N & NAT'L ASS'N OF STATE BUDGET OFFICERS, THE FISCAL SURVEY OF STATES, at ix-x (Dec. 2003) [hereinafter FISCAL SURVEY 2003], available at <http://www.nasbo.org/publications/fiscalsurvey/fiscal-survearchives/tabid/106/default.aspx> (follow "Download" hyperlink for "2003 Fall Fiscal Survey of States"); Randall G. Holcombe & Russell S. Sobel, *The Relative Variability of State Income and Sales Taxes Over the Revenue Cycle*, 23 ATLANTIC ECON. J. 97, 97 (1995). In order to cover budget shortfalls in 1991, forty-five states cut \$8 billion from budgets already enacted to cover the rising costs of Medicaid and AFDC, twenty-six states raised taxes by \$10 billion, and twenty-three states planned tax hikes for 1992. Vivian Brownstein, *Why State Budgets Are a Mess*, FORTUNE, June 3, 1991, at 21, 30. Similarly, thirty states anticipated budget shortfalls in 1981, Robert Pear, *Study Finds States in Fiscal Decline*, N.Y. TIMES, Oct. 11, 1981, at A32, and twenty-six states increased at least one tax in the first eight months of 1982, George B. Merry, *State Lawmakers' Sticky Task: Enacting New Taxes to Fill Void Left by Shrinking Federal Aid*, CHRISTIAN SCI. MONITOR, Aug. 10, 1981, at 12.

46. *Public Worker Outlook Austere; Fiscal Pressures Are Mounting*, 915 GOV'T EMP. REL. REP. (BNA) 26-27 (June 1, 1981).

47. Michael deCourcy Hinds, *Revenue Problems Endanger Budgets in Half the States*, N.Y. TIMES, Mar. 4, 1990, § 1, at 1. In all three periods, per capita state tax revenues failed to keep pace with inflation, with the most recent decline being significantly more severe than the previous two. See J. Fred Giertz & Seth H. Giertz, *The 2002 Downturn in State Revenues: A Comparative Review and Analysis*, 57 NAT'L TAX J. 111, 115 & fig.2 (2004).

era, thirty-eight states cut budgets by a record \$13.7 billion,<sup>48</sup> and the number of budget-cutting states increased to forty in the following year.<sup>49</sup> Here, too, public employers resorted to desperate measures, such as the state of Missouri, which ordered every third light bulb to be unscrewed in some government buildings in an attempt to lower the state's electricity bill.<sup>50</sup>

With nearly every state required to maintain a balanced budget,<sup>51</sup> states and local governments scrambled for ways to reduce costs.<sup>52</sup> Not surprisingly, public employers commonly took aim at their workforce costs, one of their most significant discretionary expenses.<sup>53</sup> Governmental employers have resorted to layoffs,<sup>54</sup> hiring freezes,<sup>55</sup> wage freezes,<sup>56</sup> pay lags,<sup>57</sup> and employee furloughs,<sup>58</sup> among other options during periods of budgetary turmoil.

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48. FISCAL SURVEY 2003, *supra* note 45, at 1.

49. *Id.* at ix, 1. The 2003 deficits were described as the worst state budget crisis in fifty years. See Giertz & Giertz, *supra* note 47, at 115 & fig.2; Daniel Kadlec, *How to Balance a Budget*, TIME, Dec. 9, 2002, at 50.

50. David E. Rosenbaum, *States Balance Budgets With Blue Smoke and Mirrors*, N.Y. TIMES, Aug. 24, 2003, § 4, at 4.

51. Kadlec, *supra* note 49, at 50.

52. See FISCAL SURVEY 2003, *supra* note 45, at 1.

53. See U.S. Census Bureau, *Table 1: State and Local Government Finances by Level of Government and by State: 2001-02*, [http://www.census.gov/govs/estimate/0200ussl\\_1.html](http://www.census.gov/govs/estimate/0200ussl_1.html) (last visited Nov. 6, 2010). Salaries and wages alone constituted approximately 18.5% of all direct expenditures by the states during the 2001-02 fiscal year. See *id.*

54. *E.g.*, Michael deCourcy Hinds, *Early Retirements to Reduce Budgets Cost States Money*, N.Y. TIMES, Nov. 16, 1992, at A1; Winston Williams, *States Balancing Their Budgets in Oblique Ways*, N.Y. TIMES, Sept. 1, 1982, at A16.

55. *E.g.*, Donald P. Baker, *Allen Wants \$2.1 Billion in Tax Cuts: Critics Wonder Where He'll Get the Money*, WASH. POST, Dec. 2, 1994, at A1; *Oklahoma Lawmakers Try Again on Budget Crisis*, N.Y. TIMES, Jan. 4, 1984, at A13.

56. See, *e.g.*, Dan Balz, *As Elections Near, Mayors of Three Old Cities Look Like New*, WASH. POST, Nov. 1, 1981, at A30-31; Dennis J. McGrath, *Surplus Aside, Carlson Says No to Tax Cut*, STAR TRIB. (Minn.), Mar. 2, 1994, at 1B, 4B.

57. See, *e.g.*, Hannelore Sudermann, *UI Won't Institute Employee Pay Lag*, SPOKESMAN REV. (Spokane), Apr. 28, 2004, at B3.

58. *E.g.*, Lyle V. Harris, *Budget-Cutting Proposal Includes City Furloughs*, ATLANTA J. CONST., Jan. 8, 1994, at B3.

Furloughs, or mandatory time off work with no pay, have been called the “strategy du jour” of employers seeking to cut costs while retaining good workers.<sup>59</sup> Between 2007 and 2009, over half of all states implemented mandatory furlough programs.<sup>60</sup> In 2010, our two most populous states—California and New York—ordered furloughs for a total of approximately 250,000 state employees.<sup>61</sup> Faced with double digit compensation losses due to the forced cut in work days, public employee unions challenged both orders in court, claiming that the orders contravene the terms of existing collective bargaining agreements and the contract clause.<sup>62</sup>

The four periods of state budget problems arose from similar causes. The most recent era is attributed to the burst of the housing bubble and dramatically decreased tax revenues.<sup>63</sup> The 2003-04 period similarly is blamed on shrinking tax revenues caused by the economic downturn and the rising cost of medical care.<sup>64</sup> Other factors have been implicated as well, including homeland security costs, the “No Child Left Behind” educational program, and cutbacks in aid to the states.<sup>65</sup> The state budget problems of the early

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59. Michael Z. Green, *Unpaid Furloughs and Four-Day Work Weeks: Employer Sympathy or a Call for Collective Employee Action?* 42 CONN. L. REV. 1139, 1151 (2010) (quoting Tresa Baldas, *Employment Lawyers Predict Furloughs May Lead to Lawsuits*, NAT'L L.J. (May 19, 2009), <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202430831358>) (internal quotation marks omitted).

60. Christine Vestal, *After Furloughs, States Mull Permanent Cuts*, STATELINE.ORG (Dec. 2, 2009), <http://www.stateline.org/live/details/story?contentId=440784>.

61. See Shane Goldmacher, *State Furloughs Return*, L.A. TIMES, Aug. 19, 2010, at AA3; Tom Precious, *Upholding Furloughs in Court Seen as Impossible*, BUFFALO NEWS, May 12, 2010, at A1.

62. See Goldmacher, *supra* note 61, at AA3; Precious, *supra* note 61, at A1, A3.

63. See Abby Goodnough, *States Turning to Last Resorts in Budget Crisis*, N.Y. TIMES, June 22, 2009, at A1.

64. Rosenbaum, *supra* note 50, § 4, at 4; Raymond C. Scheppach, Exec. Dir., Nat'l Governors Ass'n, *Update on the State Fiscal Crisis*, NAT'L GOVERNORS ASS'N, <http://www.nga.org/portal/site/nga/menuitem.6c9a8a9ebc6ae07eee28aca9501010a0/?vgnnextoid=2beb4c33c7732010VgnVCM1000001a01010aRCRD&vgnextchannel=0dab8f2005361010VgnVCM1000001a01010aRCRD> (Mar. 3, 2004).

65. Katherine G. Willoughby, *State Revenue Choices and Gubernatorial Initiatives*, 76 SPECTRUM 14, 15 (2003).

1990s have been attributed primarily to the economic recession,<sup>66</sup> but reduced federal aid to the states<sup>67</sup> and federally mandated state spending<sup>68</sup> also were contributing factors. Similarly, the budget shortfalls of the early 1980s were caused largely by a poor economy, and, to a lesser extent, decreased federal aid to the states.<sup>69</sup>

There is evidence that the states are largely unable to prevent budget shortfalls during cyclical recessions.<sup>70</sup> The problem of decreased tax revenues caused by economic downturns, a cause shared by each of these periods of budget shortfalls, is a problem that states are likely to continue to face in the future.<sup>71</sup> Therefore, if the states employ the same methods to close their budget deficits that they have used historically, employment costs will continue to be targeted when times get tough for state and local governments.

Complicating matters is the difficulty that state and local governments have with self-regulation and long-term planning. States could help alleviate the fiscal problems that accompany recessions if they would save money during boom periods.<sup>72</sup> However, political pressures work against such responsible planning, as tax cuts become politically popular when governments run surpluses.<sup>73</sup>

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66. See Janet G. Stotsky, *Coping with State Budget Deficits*, BUS. REV., Jan.-Feb. 1991, at 13-14.

67. *Id.* at 14, 18.

68. Hinds, *supra* note 47, § 1, at 1.

69. Steven D. Gold, *Federal Aid and State Finances*, 35 NAT'L TAX J. 373, 380-81 (1982). The fiscal crises in 1981 may have been caused in part or exacerbated by federal government actions to shift burdens onto state and local governments. See *A Challenge to the GOP's New Grass-Roots Power*, BUS. WK. (SPECIAL REPORT: STATE AND LOCAL GOVERNMENT IN TROUBLE), Oct. 26, 1981, at 176, 178.

70. Giertz & Giertz, *supra* note 47, at 112, 129-30.

71. Holcombe & Sobel, *supra* note 45, at 111.

72. See *id.*; James A. Papke, *The Response of State-Local Government Taxation to Fiscal Crisis*, 36 NAT'L TAX J. 401, 404 (1983).

73. See *id.*

### III. COMPARING UNILATERAL CHANGE RULES IN THE PRIVATE AND PUBLIC SECTORS

The bilateral determination of terms and conditions of employment constitutes a fundamental cornerstone of modern labor relations. Indeed, the bilateral collective bargaining process between unions and employers is the principal source of employee voice in the American workplace.<sup>74</sup> Unilateral action—the alteration of existing terms, policies, or practices by only one party privy to a collective bargaining relationship—generally diminishes voice as well as the therapeutic nature of the collective bargaining process.

Unilateral change, however, is not always unlawful, and the range of permissible unilateral action varies by sector. Although private sector unilateral change rules serve as a starting point for determining public sector unilateral change rules, courts and state labor boards have seized on real and perceived differences between the two sectors to permit a greater degree of unilateral change in the public sector.

#### A. *Private Sector*

Unilateral change rules in the private sector underscore the role of bilateral negotiation as a usual condition precedent to the adjustment of terms and conditions of employment.<sup>75</sup> The NLRA requires employers and labor organizations to bargain in good faith over “wages, hours, and other terms and conditions of employment.”<sup>76</sup> As the Supreme Court acknowledged in *NLRB v. Wooster Division of Borg-Warner Corp.*, the duty to bargain extends only to those mandatory subjects.<sup>77</sup> Although neither party is forced

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74. See STEPHEN F. BEFORT & JOHN W. BUDD, *INVISIBLE HANDS, INVISIBLE OBJECTIVES: BRINGING WORKPLACE LAW AND PUBLIC POLICY INTO FOCUS* 106-08 (2009).

75. The rules governing unilateral change in the private sector are relatively well-established. For discussion of these rules, see generally Terrence H. Murphy, *Impasse and the Duty to Bargain in Good Faith*, 39 U. PITT. L. REV. 1 (1977); Robert J. Rabin, *Limitations on Employer Independent Action*, 27 VAND. L. REV. 133 (1974).

76. 29 U.S.C. § 158(d) (2006); see also 29 U.S.C. § 158(a)(5), (b)(3) (2006).

77. 356 U.S. 342, 349 (1958).

to make concessions on mandatory subjects,<sup>78</sup> the parties are required to bargain in good faith with a present intention to find a basis for agreement.<sup>79</sup> Conversely, the parties have no obligation to bargain over non-mandatory or permissive subjects,<sup>80</sup> and unilateral action generally is lawful with regard to such topics absent an agreement to the contrary.<sup>81</sup> Courts tend to construe the scope of mandatory bargaining broadly and limit permissive bargaining subjects to topics that do not significantly relate to terms and conditions of employment<sup>82</sup> or that involve managerial concerns going to the “core of entrepreneurial control.”<sup>83</sup>

Although the prevailing unilateral change rules for private sector bargaining vary depending on the presence or absence of a collective bargaining agreement, the bargaining obligation predominates in both contexts. In *NLRB v. Katz*, a case that arose in the absence of a collective bargaining agreement, the Supreme Court held that an employer’s unilateral implementation of changes in existing wage, sick leave, and merit pay plans without bargaining with the exclusive representative constituted a per se violation of Section 8(a)(5) of the NLRA, even in the absence of bad faith.<sup>84</sup> The *Katz* decision does not completely

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78. § 158(d).

79. See *NLRB v. Herman Sausage Co.*, 275 F.2d 229, 231 (5th Cir. 1960); *NLRB v. Montgomery Ward & Co.*, 133 F.2d 676, 683-84 (9th Cir. 1943).

80. See *Borg-Warner Corp.*, 356 U.S. at 349 (“As to other [non-mandatory] matters, however, each party is free to bargain or not to bargain, and to agree or not to agree.”).

81. See *First Nat’l Maint. Corp. v. NLRB*, 452 U.S. 666, 680-86 (1981); *Allied Chem. & Alkali Workers of Am., Local Union No. 1 v. Pittsburgh Plate Glass Co., Chem. Div.*, 404 U.S. 157, 187-88 (1971). The NLRA and other legislation prohibit the inclusion in a labor agreement of a third class of “illegal” subjects, and parties may not condition an agreement on inclusion of such terms even if they relate to wages, hours, or working conditions. See *In re Nat’l Mar. Union of Am.*, 78 N.L.R.B. 971, 981-82 (1948), *enforced*, 175 F.2d 686 (2d Cir. 1949).

82. See, e.g., *United Food & Commercial Workers Int’l Union v. NLRB*, 1 F.3d 24 (D.C. Cir. 1993) (holding that employer had no duty to bargain over its decision to relocate); *Westinghouse Elec. Corp. v. NLRB*, 387 F.2d 542, 547-48 (4th Cir. 1967) (holding that employer had no duty to bargain over prices set by independent contractor who operated cafeterias in its plants).

83. *Fibreboard Paper Prods. Corp. v. NLRB*, 379 U.S. 203, 223 (1964) (Stewart, J., concurring).

84. 369 U.S. 736, 743 (1962).

eliminate the possibility of unilateral action, however, since either party,<sup>85</sup> after bargaining to impasse,<sup>86</sup> may implement “unilateral changes that are reasonably comprehended within [its] pre-impasse proposals.”<sup>87</sup>

Rules governing unilateral change during the term of a collective bargaining agreement are more complex. In this setting, the NLRA’s preference for the bargaining process must be balanced against the stability afforded by adherence to the bargain already struck. Section 8(d) states that the duty to bargain described in that section “shall not be construed as requiring either party to discuss or agree to any modification of the terms and conditions contained in a contract for a fixed period.”<sup>88</sup> The determinative factor is whether a topic is “contained in” the contract. If a bargaining proposal seeks to modify a term contained in the contract, neither party lawfully may insist on bargaining, and the term can be changed only with the mutual consent of the parties.<sup>89</sup> Even if the topic is not already addressed in the contract, neither party may implement a mandatory bargaining proposal without first bargaining to impasse.<sup>90</sup>

The unilateral change proscription also applies to the period following the expiration of a bargaining agreement,

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85. Unilateral change rules technically apply to the conduct of both employers and labor organizations. Of course, employers are more often in a position to effectuate unilateral action, and this Article focuses on their conduct. See NLRA § 8(b)(3), 29 U.S.C. § 158(b)(3) (2006). A few cases, however, have found that unions that force a change in working conditions without bargaining violate § 8(b)(3). See, e.g., *N.Y. Dist. Council No. 9, Int’l Bhd. of Painters & Allied Trades v. NLRB*, 453 F.2d 783, 787 (2d Cir. 1971) (condemning union’s unilateral imposition of work quota).

86. The determination of whether an “impasse” exists is a highly fact-specific inquiry in which the NLRB attempts to determine whether, despite good faith bargaining efforts, the parties have reached the point of deadlock. See *TruServ Corp. v. NLRB*, 254 F.3d 1105, 1114 (D.C. Cir. 2001); *Duffy Tool & Stamping, L.L.C. v. NLRB*, 233 F.3d 995, 999 (7th Cir. 2000) (upholding NLRB decision ruling that unilateral action may not be premised on the existence of an impasse on only one of many topics under negotiation).

87. *Taft Broadcasting Co.*, 163 N.L.R.B. 475, 478 (1967).

88. NLRA § 8(d), 29 U.S.C. § 158(d) (2006).

89. See *NLRB v. Lion Oil Co.*, 352 U.S. 282, 285, 289-94 (1957); *C & S Indus., Inc.*, 158 N.L.R.B. 454, 460 (1966).

90. See, e.g., *Int’l Woodworkers of Am., Local 3-10 v. NLRB*, 380 F.2d 628, 629-30 (D.C. Cir. 1967).



during which time the parties may not alter the status quo concerning mandatory terms without first bargaining to impasse.<sup>91</sup> The status quo that the parties must maintain is a dynamic one that encompasses a past pattern of periodic adjustments. Thus, an employer commits an unfair labor practice by refusing to provide regularly scheduled wage or merit increases provided in an expired contract unless bargaining results in either a different agreement or an impasse.<sup>92</sup>

The private sector unilateral change rules therefore emphasize collective negotiation as the preferred process for establishing employment terms.<sup>93</sup> Consistent with this overriding preference for the bargaining process, the NLRB<sup>94</sup> and courts<sup>95</sup> refuse to recognize economic factors as a justification for unilateral change. In *Oak Cliff-Golman Baking Co.*, for example, the employer unilaterally reduced the wage rates specified in the current collective bargaining agreement in response to a severe economic crisis.<sup>96</sup> In rejecting the employer's economic necessity defense, the NLRB stated that "[n]owhere in the statutory terms is any authority granted to us to excuse the commission of the proscribed action because of a showing either that such action was compelled by economic need or that it may have

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91. See, e.g., *Litton Fin. Printing Div. v. NLRB*, 501 U.S. 190, 198 (1991); *Laborers Health & Welfare Trust Fund for N. Cal. v. Advanced Lightweight Concrete Co.*, 484 U.S. 539, 544 n.6 (1988) (quoting *NLRB v. Katz*, 369 U.S. 736, 743 (1962)). Contract terms that govern the employer-union relationship, however, generally do not survive contract expiration. See Warren C. Ogden et al., *The Survival of Contract Terms Beyond the Expiration of a Collective Bargaining Agreement*, 32 LAB. L.J. 119, 121 (1981).

92. See *Reed Seismic Co. v. NLRB*, 440 F.2d 598, 601 (5th Cir. 1971) (quoting *NLRB v. S. Coach & Body Co.*, 336 F.2d 214, 217 (5th Cir. 1964)).

93. See NLRA § 1, 29 U.S.C. § 151 (2006) ("It is hereby declared to be the policy of the United States to . . . encourag[e] the practice and procedure of collective bargaining . . ."); see also David P. Findling & William E. Colby, *Regulation of Collective Bargaining by the National Labor Relations Board—Another View*, 51 COLUM. L. REV. 170, 170 (1951) (stating that collective bargaining forms the foundation for the national labor policy).

94. See, e.g., *FWD Corp.*, 257 N.L.R.B. 1300, 1301 (1981); *Morelli Constr. Co.*, 240 N.L.R.B. 1190, 1190 (1979).

95. See, e.g., *Arco Elec. Co. v. NLRB*, 618 F.2d 698, 700 (10th Cir. 1980).

96. 207 N.L.R.B. 1063 (1973), *enforced mem.*, 505 F.2d 1302 (5th Cir. 1974), *cert. denied*, 423 U.S. 826 (1975).

served what may appear to us to be a desirable economic objective.”<sup>97</sup> Thus, although economic necessity may justify a particular bargaining posture, it cannot, short of bankruptcy, warrant repudiation of the bargaining process itself or of the resulting contractual commitments.

### B. *Public Sector*

Since public employers are expressly excluded from coverage under the NLRA,<sup>98</sup> the regulation of state and local labor relations is left to the individual states which have adopted a variety of approaches. Approximately 80% of the states have adopted statutes authorizing collective bargaining for at least some groups of public employees.<sup>99</sup> Some of these statutes cover state and local employees comprehensively, while a greater number apply only to certain occupational groups such as teachers or public safety employees.<sup>100</sup> On the other hand, a handful of states have statutes that prohibit public sector collective bargaining.<sup>101</sup> Still another small group of states has no legislation dealing with public sector bargaining rights.<sup>102</sup> In some of these jurisdictions, legislative silence is deemed tantamount to a ban on collective bargaining,<sup>103</sup> while in other jurisdictions courts permit collective bargaining on a voluntary basis.<sup>104</sup> Clearly, public employers in jurisdictions that do not permit collective bargaining have full unilateral authority to set and alter terms and conditions of employment.

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97. *Id.* at 1064.

98. 29 U.S.C. § 152(2) (2006).

99. GRODIN ET AL., *supra* note 8, at 82.

100. *Id.* at 88-91.

101. *See, e.g.*, VA. CODE ANN. §§ 40.1-57.2 (2010) (providing that no public employer in the state has any authority to enter into any collective bargaining agreement).

102. *See* James C. May, *The Law and Politics of Paying Teachers Salary Step Increases upon Expiration of a Collective Bargaining Agreement*, 20 VT. L. REV. 753, 776-80 (1996).

103. *See id.* at 776 & nn.155, 157, 160, 163.

104. *See, e.g.*, Littleton Educ. Ass’n v. Arapahoe Cnty. Sch. Dist., 553 P.2d 793, 795-97 (Colo. 1976).

Most jurisdictions with comprehensive bargaining laws espouse unilateral change principles similar to those in the private sector. Labor boards and courts in these states find that it is an unfair labor practice for public employers to unilaterally alter terms established in current<sup>105</sup> or expired<sup>106</sup> collective bargaining agreements without engaging in the collective bargaining process. Many decisions also follow *Oak Cliff-Golman Baking Co.* in holding that economic hardship does not justify the unilateral modification of employment terms.<sup>107</sup> Most jurisdictions also similarly find that a public employer may lawfully modify existing terms after first bargaining to impasse,<sup>108</sup> although this point in time is often delayed until the completion of required dispute resolution procedures such as mediation and fact-finding.<sup>109</sup>

Unilateral change nonetheless is more prevalent in the public sector, with the bases for such expanded unilateral change opportunities corresponding to the perceived structural and political process differences between collective bargaining in the two sectors.<sup>110</sup> As discussed in an earlier article, these additional unilateral change possibilities generally occur for the following reasons:

1) Diffused management authority resulting from the separation of governmental powers, such as where the bargaining and appropriations functions are vested in different governmental entities;

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105. See, e.g., *Wilkes-Barre Twp. v. Pa. Labor Relations Bd.*, 878 A.2d 977, 983 (Pa. Commw. Ct. 2005).

106. See, e.g., *Educ. Minn.-Greenway, Local 1330 v. Indep. Sch. Dist. No. 316*, 673 N.W.2d 843, 853 (Minn. Ct. App. 2004); *Appeal of City of Nashua Bd. of Educ.*, 695 A.2d 647, 653 (N.H. 1997); *Cent. Dauphin Educ. Ass'n v. Cent. Dauphin Sch. Dist.*, 792 A.2d 691, 698 (Pa. Commw. Ct. 2001).

107. See, e.g., *Chiles v. United Faculty of Fla.*, 615 So. 2d 671, 673 (Fla. 1993); *AFSCME/Iowa Council 61 v. State*, 484 N.W.2d 390, 391 (Iowa 1992); *Prof'l. Staff Cong./CUNY v. Bd. of Higher Educ.*, 373 N.Y.S.2d 453, 455 (N.Y. Sup. Ct. 1975).

108. See, e.g., *Alaska Pub. Emps. Ass'n v. State*, 776 P.2d 1030, 1032-33 (Alaska 1989).

109. See, e.g., *Moreno Valley Unified Sch. Dist. v. Pub. Emp't Relations Bd.*, 191 Cal. Rptr. 60, 66 (Cal. Ct. App. 1983); *Mountain Valley Educ. Ass'n v. Me. Sch. Admin. Dist. No. 43*, 655 A.2d 348, 352 (Me. 1995); *AFSCME Council 25 v. Wayne Cnty.*, 393 N.W.2d 889, 894 (Mich. Ct. App. 1986).

110. See Befort, *Public Sector Bargaining*, *supra* note 5, at 1231-35.

- 2) Governmental lawmaking that modifies a previously negotiated agreement;
- 3) The preemption of negotiated terms by a pre-existing statute or rule;
- 4) A more restricted scope of mandatory bargaining in the public sector;
- 5) A denial of contract enforcement due to public policy grounds and/or the elimination of permissive bargaining topics in some jurisdictions; and
- 6) The rejection of the dynamic status quo doctrine in favor of a static status quo doctrine.<sup>111</sup>

This Article focuses on the second-listed reason—the government’s law-making function. Here the source of unilateral action generally is the state legislature. As the supreme law-making body of state government, the legislature retains the authority to amend its own collective bargaining legislation and to enact superseding statutes governing employment matters, subject only to constitutional restraints.<sup>112</sup> The contract clause of the United States Constitution<sup>113</sup> is the principal constitutional limitation on the legislature’s authority to modify existing collective bargaining agreements. After a brief discussion of bankruptcy as a unilateral change alternative, the next Part examines the tug-of-war between the law-making function and the contract clause in the context of cyclical periods of public sector fiscal crises.

### C. *The Bankruptcy Alternative*

In *NLRB v. Bildisco & Bildisco*, the Supreme Court held that a bankruptcy court may authorize the rejection of a collective bargaining agreement in a bankruptcy reorganization proceeding if the agreement burdens the employer’s estate and the equities balance in favor of rejection.<sup>114</sup> The Court also rejected the applicability of

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111. *See id.* at 1235-74.

112. *See generally* UAW v. Fortuño, 645 F. Supp. 2d 56, 61 (D. P.R. 2009) (explaining that a legislature generally retains the right to suspend or modify previously enacted legislation).

113. U.S. CONST. art. I, § 10, cl. 1.

114. 465 U.S. 513, 526-27 (1984).

NLRA § 8(d) in the reorganization context and held that an employer, as a debtor-in-possession following the filing of a bankruptcy petition, does not commit an unfair labor practice by unilaterally altering contract terms prior to the bankruptcy court's formal rejection of the contract.<sup>115</sup>

Congress moved quickly to modify the *Bildisco* decision by amending Chapter 11 of the Bankruptcy Code, applicable to the reorganization of private businesses, so as to add a new § 1113, which specifically addresses the rejection of collective bargaining agreements.<sup>116</sup> Section 1113 provides that prior to rejection of a collective bargaining agreement, a debtor-in-possession must make a proposal to the authorized employee representative that outlines those contract modifications necessary to permit reorganization and must confer in good faith with the representative in an attempt to reach agreement.<sup>117</sup> Such a proposal must treat all debtors, creditors, or other affected parties fairly and equitably.<sup>118</sup> The bankruptcy court may reject the labor contract only if the union representative refuses to accept the proposal "without good cause" and the "balance of the equities clearly favors rejection."<sup>119</sup> Section 1113 also prohibits unilateral modification by the debtor-in-possession in the absence of a bankruptcy court determination that the interim changes are "essential to the continuation of the debtor's business, or [needed] in order to avoid irreparable damage to the estate."<sup>120</sup>

The Bankruptcy Code, in Chapter 9, also authorizes municipal entities to file a petition for reorganization.<sup>121</sup> Since Section 1113 only applies to Chapter 11 proceedings, the *Bildisco* decision continues to provide the applicable standard for the rejection of collective agreements in municipal bankruptcy proceedings.<sup>122</sup> Although the *Bildisco*

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115. *Id.* at 534.

116. *See* 11 U.S.C. § 1113 (2006).

117. § 1113(b)(1), (2).

118. § 1113(b)(1)(A).

119. § 1113(c).

120. § 1113(e).

121. 11 U.S.C. §§ 901-46 (2006).

122. *See In re Cnty. of Orange*, 179 B.R. 177, 183 (Bkrtcy. C.D. Cal. 1995); Ryan Preston Dahl, *Collective Bargaining Agreements and Chapter 9 Bankruptcy*, 81 AM. BANKR. L.J. 295, 297 (2007).

standard appears to provide an easier path for municipal employers seeking the rejection of a collective bargaining agreement,<sup>123</sup> very few municipalities have utilized this process.<sup>124</sup> This is likely due to two factors. First, a municipality may file a Chapter 9 petition only with the consent of the state in which the municipality is located.<sup>125</sup> Second, a municipality is eligible to invoke Chapter 9 procedures only if it is insolvent.<sup>126</sup>

While bankruptcy provides an alternative means for an employer to obtain relief from the terms of an existing collective bargaining agreement, this route differs from unilateral modifications in a number of important respects. For one thing, the rejection of a collective bargaining agreement can be accomplished in bankruptcy only with the approval of a third-party decision maker, as opposed to the unfettered action of the employer itself.<sup>127</sup> In addition, a bankruptcy court typically will consider the other obligations and assets of the employer rather than just the terms of the collective bargaining agreement in isolation.<sup>128</sup>

#### IV. THE CONTRACT CLAUSE THROUGH THREE PERIODS OF PUBLIC SECTOR BUDGET CRISIS

##### A. *The Contract Clause*

The contract clause of the United States Constitution provides that “No [s]tate shall . . . pass any . . . [l]aw

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123. See Dahl, *supra* note 122, at 297, 314.

124. See *id.* at 335-36 (describing Chapter 9 bankruptcy as “an extraordinary remedy of last resort”); see also W. Richard Fossey, *Inability to Pay Salaries Under Collective Bargaining Agreements—U.S. Bankruptcy Court as a School District’s Option*, 50 EDUC. L. REP. 651, 651 (1989) (identifying two school districts that had resorted to Chapter 9 proceedings).

125. 11 U.S.C. § 109(c)(2) (2006).

126. § 109(c)(3).

127. See 11 U.S.C. § 1113(c) (2006) (providing that a bankruptcy court may authorize the rejection of a collective bargaining agreement only if the balance of the equities favors rejection).

128. See 11 U.S.C. § 1113(b)(1)(A) (2006) (requiring a bankruptcy court to consider whether the proposal for rejection treats all debtors, creditors, and other affected parties “fairly and equitably”).

impairing the [o]bligation of [c]ontracts . . . .”<sup>129</sup> The apparent purpose underlying the adoption of the contract clause was to prevent states from hampering commercial activity through the enactment by states of debtor relief laws.<sup>130</sup> For the first century of this country’s existence, “[t]he contract clause was the primary [federal] constitutional restraint on state and local regulation of business . . . .”<sup>131</sup>

The relative importance of the contract clause began to wane following the adoption of the Fourteenth Amendment and the development of the Supreme Court’s due process jurisprudence.<sup>132</sup> An even greater limitation stemmed from the rise of the police power doctrine, which recognized the right of the states to enact legislation designed to serve the public interest.<sup>133</sup> Over time, the Supreme Court came to recognize that state regulation does not violate the contract clause where it is reasonably tailored to “promote the health, comfort, safety, or welfare of the community.”<sup>134</sup>

The police power limitation reached its zenith in the Supreme Court’s landmark 1934 decision in *Home Building & Loan Ass’n v. Blaisdell*.<sup>135</sup> That decision involved a contract clause challenge to the Minnesota Mortgage Moratorium Law, a depression-era statute that permitted courts to extend the time during which a debtor could redeem mortgaged property.<sup>136</sup> The law did not invalidate the underlying mortgage, but it did authorize a postponement in foreclosure rights so long as the debtor

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129. U.S. CONST. art. I, § 10, cl. 1.

130. See Letter from James Madison to Thomas Jefferson (Oct. 24, 1787), in 10 THE PAPERS OF JAMES MADISON 205, 206, 212 (Robert A. Rutland et al. eds., 1977); 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, 1380-83 (1992).

131. Leo Clarke, *The Contract Clause: A Basis for Limited Judicial Review of State Economic Regulation*, 39 U. MIAMI L. REV. 183, 187-88 (1985).

132. See *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241 & n.12 (1978) (citing Robert L. Hale, *The Supreme Court and the Contract Clause: III*, 57 HARV. L. REV. 852, 890-91).

133. See Clarke, *supra* note 131, at 190-92.

134. *Atl. Coast Line R.R. v. City of Goldsboro*, 232 U.S. 548, 559 (1914).

135. 290 U.S. 398 (1934).

136. *Id.* at 415-18.

paid the rental value of the property to the lender during the interim period.<sup>137</sup> After summarizing the existing case law, the Supreme Court stated that the pertinent “question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end.”<sup>138</sup> Thus, even though the Minnesota law directly conflicted with contract-based foreclosure rights, the *Blaisdell* Court upheld the law on the grounds that the state retains the authority “to safeguard the vital interests of its people.”<sup>139</sup> In reaching this conclusion, the Court stressed five significant attributes of the Minnesota statute:

First, the state legislature had declared in the Act itself that an emergency need for the protection of homeowners existed. Second, the state law was enacted to protect a basic societal interest, not a favored group. Third, the relief was appropriately tailored to the emergency that it was designed to meet. Fourth, the imposed conditions were reasonable. And, finally, the legislation was limited to the duration of the emergency.<sup>140</sup>

After many years of deferring to state legislative impairments, in 1977 the Supreme Court revitalized the contract clause in the context of government contracts. In *United States Trust Co. of New York v. New Jersey*,<sup>141</sup> the Court invalidated a New Jersey statute that retroactively repealed a covenant between the state and certain bondholders that limited the use of revenues pledged as security for rail passenger transportation purposes.<sup>142</sup> In striking down the New Jersey statute, the Supreme Court adopted a heightened standard for scrutinizing laws that impair public contracts, stating that “complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State’s self-interest is at

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137. *See id.*

138. *Id.* at 438.

139. *Id.* at 434.

140. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242 (1978) (citations omitted) (summarizing *Blaisdell*, 290 U.S. at 444-47).

141. 431 U.S. 1 (1977).

142. *See id.* at 9-14.



stake[.]”<sup>143</sup> and that “a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives.”<sup>144</sup> The Court went on to explain that a more exacting standard is appropriate in this context because:

A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. 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.<sup>145</sup>

The impairment of public contracts is constitutional, the Court stated, only if it is “reasonable and necessary to serve an important public purpose.”<sup>146</sup> The Court noted that an impairment is “reasonable” only if the parties did not foresee at the time of contracting the possibility of changed circumstances,<sup>147</sup> and is “necessary” only if there are no less drastic alternatives available for safeguarding the public interest.<sup>148</sup>

A year later, the Court appeared to increase its scrutiny of private contracts as well.<sup>149</sup> Subsequent decisions, however, found the Court reverting to its longstanding policy of giving substantial deference to legislative police power actions that serve to modify private contracts.<sup>150</sup> Those decisions, however, did not undercut the applicability of *United States Trust* to governmental contracts,<sup>151</sup> and the

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143. *Id.* at 26.

144. *Id.* at 30.

145. *Id.* at 26.

146. *Id.* at 25.

147. *Id.* at 31-32.

148. *Id.* at 29-31.

149. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242-51 (1978) (holding a Minnesota statute imposing a pension funding charge on certain employers terminating their plan or leaving the state to be an unconstitutional impairment of contract obligations).

150. *See Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 409-19 (1983) (finding Kansas statute limiting ceiling prices on natural gas sold intrastate consistent with contract clause); *Exxon Corp. v. Eagerton*, 462 U.S. 176, 187-94 (1983) (finding Alabama statute increasing severance tax on oil and gas not in violation of contract clause).

151. *See Clarke*, *supra* note 131, at 210-11.

lower courts continue to apply the principles of *United States Trust* when analyzing legislation attempting to modify collective bargaining agreements.<sup>152</sup>

Contract clause analysis is particularly significant when a state legislative body attempts such modifications. The decision of the Minnesota Supreme Court in *AFSCME Council 6 v. Sundquist*<sup>153</sup> illustrates that the unilateral modification of public sector bargaining agreements by a state legislature generally implicates constitutional, as opposed to statutory, issues. In *Sundquist*, the Minnesota Supreme Court upheld a statute passed by the Minnesota legislature adopting, *inter alia*,<sup>154</sup> a new leave-of-absence policy for state employees.<sup>155</sup> Although the court acknowledged that the adoption of this policy resulted in the unilateral alteration of employment terms established in existing collective bargaining agreements,<sup>156</sup> it held that the new statutory provision could not be challenged as an unfair labor practice because the Minnesota Public Employment Labor Relations Act, like most other state bargaining laws,<sup>157</sup> did not include the legislature within its definition of a “public employer.”<sup>158</sup> The court explained that the sole avenue for challenging a unilateral legislative modification of collective bargaining agreement terms is to proceed under state and federal constitutional provisions.<sup>159</sup>

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152. See *infra* Part IV.B-D.

153. 338 N.W.2d 560 (Minn. 1983).

154. The principal legislative action challenged in *Sundquist* was a requirement that various state and local employees contribute an additional two percent of their salaries to their pension funds during 1983. *Id.* at 565. The court upheld this provision on the grounds that the legislature’s modification of contribution rates did not abridge any contract rights, *id.* at 567-69, and that pension matters are illegal topics of bargaining under Minnesota’s public sector labor relations statute, *id.* at 575-76.

155. Specifically, the Act provided that through the first half of 1983, state employees taking unpaid leaves of absence could continue to accrue most of their fringe benefits as if they had been working during the period of their leaves. *Id.* at 565.

156. *Id.* at 577.

157. See Blair, *supra* note 20, at 11.

158. *Sundquist*, 338 N.W.2d at 577. Minnesota’s bargaining law at the time provided that the Commissioner of Employee Relations was the statutory “employer” of all state employees. See MINN. STAT. § 179A.22(2) (1984).

159. *Sundquist*, 338 N.W.2d at 577.

Thus, unilateral action that would be an unfair labor practice if undertaken by any other public or private employer is lawful if done by the state legislature as long as the action is not unconstitutional. The contract clause represents the principal constitutional check on such legislative action.<sup>160</sup>

The remainder of this Part examines the judicial construction of the contract clause in reaction to legislative modifications of collective bargaining agreements. This examination occurs in a largely chronological fashion that reflects the periodic cycles of public sector budgetary crises that have spurred such legislative actions. As this examination illustrates, while contemporary public sector collective bargaining may have emerged during the fiscal heydays of the 1960s and 1970s,<sup>161</sup> cyclical budgetary shortfalls over the next thirty years have repeatedly tested the inherent tension between public sector collective bargaining and the legislative law-making function.

#### B. *Legislative Modifications: The 1970s and 1980s*

The first two courts to address this issue adopted very different modes of analysis. They also reached very different results.

In *Subway-Surface Supervisors Ass'n v. New York City Transit Authority*,<sup>162</sup> the New York Court of Appeals upheld the validity of the 1975 Financial Emergency Act for the City of New York, an act that suspended all employee wage increases for a one-year period.<sup>163</sup> The statute impaired the collective bargaining agreement covering a unit of city transit workers by eliminating a 5% wage increase for the second year of a two-year contract.<sup>164</sup> Stating that the legislative determination deserves at least "some deference[.]" the court found that the circumstances of the fiscal crisis "clearly demonstrate that the Legislature's conclusion was a valid one."<sup>165</sup> As an important factor, the

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160. See Befort, *Public Sector Bargaining*, *supra* note 5, at 1246.

161. See *supra* notes 19-25 and accompanying text.

162. 375 N.E.2d 384 (N.Y. 1978).

163. *Id.* at 387-88.

164. *Id.* at 387.

165. *Id.* at 390.

court noted the impact of the Act was merely prospective in nature; the suspended future increases were considered unearned and not vested since the employees had the right to quit in response to the legislative modification.<sup>166</sup> Finally, the court held the preferential treatment it previously gave the contract rights of municipal bondholders<sup>167</sup> did not create an equal protection problem because the bondholders' rights had vested and the impairment of their rights would have a significantly greater impact than would impairing employee rights in terms of worsening the City's credit rating.<sup>168</sup>

The California Supreme Court took an approach that was less deferential to legislative modification in *Sonoma County Organization of Public Employees v. County of Sonoma*.<sup>169</sup> In response to Proposition 13, which eliminated approximately \$7 billion in property tax revenues that would have been available to municipal governments, the California legislature enacted a bill that distributed \$5 billion in surplus state funds to local entities on the condition that the recipient entities would not implement wage increases for the 1978-1979 fiscal year.<sup>170</sup> Like the legislative action in *Subway-Surface Supervisors*, this action modified several collective bargaining agreements providing for second-year wage adjustments.<sup>171</sup> The *Sonoma County Public Employees* court, in holding that the action of the California legislature unconstitutionally impaired the employees' right to contract, distinguished *Subway-Surface Supervisors* on several grounds. The court noted that New York City's fiscal crisis was more severe than California's<sup>172</sup>

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166. *Id.* at 390-91.

167. See *Flushing Nat'l Bank v. Mun. Assistance Corp.*, 358 N.E.2d 848, 850 (N.Y. 1976).

168. *Subway-Surface Supervisors*, 375 N.E.2d at 391.

169. 591 P.2d 1 (Cal. 1979).

170. *Id.* at 3, 8.

171. See *id.* at 3; *Subway-Surface Supervisors*, 375 N.E.2d at 387.

172. Although everyone acknowledged the severity of the fiscal crisis in New York City, the crisis created in California by Proposition 13 was largely ameliorated by the legislature's subsequent distribution of surplus funds. See *Sonoma Cnty. Org. of Pub. Emps.*, 591 P.2d at 8-9. Because the government failed in *Sonoma County Public Employees* to establish the existence of a true emergency, the court did not rule on the union's contention that any emergency resulting from the adoption of Proposition 13 was created by the state's

and that the impairment in the New York case was less burdensome because it merely deferred, rather than eliminated, the wage increases.<sup>173</sup> In addition to drawing these factual distinctions, the California court rejected the supposition in *Subway-Surface Supervisors* that the elimination of future wage increases provided for in a contract abridged only prospective, non-vested rights.<sup>174</sup> The *Sonoma County Public Employees* court instead found that a multiple-year contract constitutes an indivisible whole for which employees render consideration from the time of its commencement, explaining:

[W]e seriously question the New York court's rationale. A contract must be viewed as a whole; it cannot be fractured into isolated components. The anticipated wage increases during the second year thereof may have affected the employees' wage demands for the first year of the contract, and undoubtedly many employees rendered their services in the first year in anticipation of their contractual right to the second year increase. It is doubtful, therefore, that the New York court was correct in its conclusion that the employees had not rendered consideration for the second year of the contract when the freeze was imposed.<sup>175</sup>

The two remaining decisions issued during this period continued this disparate view. In *Local Division 589, Amalgamated Transit Union v. Massachusetts*, a 1981 decision, the First Circuit Court of Appeals upheld a legislative modification against a contract clause challenge.<sup>176</sup> In that case, the Massachusetts legislature passed a statute changing the arbitration process for resolving future transit bargaining disputes, ostensibly for the purpose of "hold[ing] down rapidly rising transit costs."<sup>177</sup> The First Circuit reviewed the *United States Trust* decision and, while noting that "complete deference" to

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voluntary conduct in limiting its taxing authority and, therefore, could not justify an impairment of contract. The court did indicate, however, that it found this argument "appealing." *See id.* at 10.

173. *Id.* at 9.

174. *See id.* at 9-10.

175. *Id.* at 10.

176. 666 F.2d 618, 620 (1st Cir. 1981).

177. *Id.* at 621. The principal change affected by the legislation was to reduce the size of interest arbitration panels from three members to a single arbitrator. *Id.* at 622.

legislative action is not appropriate with respect to the alteration of government contracts, found that at least some level of deference is appropriate: “We do not believe that *United States Trust* requires the federal courts to go further to reexamine *de novo* all the factors underlying the legislation and to make a totally independent determination about whether a fare increase or some other alternative would have constitute a ‘better’ statutory solution.”<sup>178</sup> In this instance, the court concluded that the legislature’s modification had only a slight impact on reliance interests since the modification affected only the future form of the arbitration process rather than the substance of a particular outcome.<sup>179</sup>

Four years later, the Washington Supreme Court reached a very different outcome in *Carlstrom v. State*.<sup>180</sup> In that case, the Washington state legislature, citing budgetary concerns, rescinded an earlier appropriation that funded an already negotiated salary increase for community college teachers.<sup>181</sup> The court found that the legislative modification was not “reasonable” for contract clause purposes, explaining that “[s]ince the State was fully aware of its financial problems while negotiating and prior to signing the Agreement, it cannot now be permitted to avoid the Agreement based on those same economic circumstances. Although the financial situation worsened, it was a change in degree, not in kind.”<sup>182</sup>

The Washington court also distinguished the *Subway-Surface Supervisors* decision by noting that the impairment at issue in that case allegedly implicated health and safety considerations, while the state asserted only financial considerations in this case.<sup>183</sup>

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178. *Id.* at 642.

179. *Id.* at 640 (describing the change as “procedural and therefore more akin to a contractual remedy than a contractual right”).

180. 694 P.2d 1 (Wash. 1985).

181. *Id.* at 3.

182. *Id.* at 5-6.

183. *Id.* at 5 (suggesting that financial considerations alone do not constitute sufficient police power grounds to justify an impairment of contract).

C. *Legislative Modifications: The 1990s*

Judicial decisions during the 1990s focused primarily on the constitutionality of legislative acts that temporarily deferred or reduced public employee wages in violation of applicable collective bargaining agreements. Courts generally applied a three-pronged test fashioned on principles established in the *United States Trust* decision.<sup>184</sup> This test inquires: (1) whether state action in fact impaired a contractual obligation; (2) whether the impairment is substantial in nature; and (3) whether the impairment nonetheless is reasonable and necessary to serve an important public purpose.<sup>185</sup> Courts utilizing this approach generally balance the severity of the contractual impairment with the state's need to take such action in the broader public interest.<sup>186</sup>

A number of decisions found "lag-payroll statutes" to be in violation of the contract clause.<sup>187</sup> A "lag-payroll statute" essentially operates as an involuntary loan to a public employer by delaying the point in time in which employees receive payment of wages or salaries already earned.<sup>188</sup>

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184. See *U. S. Trust Co. v. New Jersey*, 431 U.S. 1 (1977).

185. See, e.g., *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1015 (4th Cir. 1993); *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708, 712-13 (Mass. 1995).

186. *Mass. Cmty. Coll.*, 649 N.E.2d at 713 ("The extent of any impairment is a factor in determining its reasonableness, as is the importance of the public purpose to be served. An impairment is not a reasonable one if the problem sought to be resolved by an impairment of a contract existed at the time the contractual obligation was incurred. If the foreseen problem has changed between the time of the contracting and the time of the attempted impairment, but has changed only in degree and not in kind, the impairment is not reasonable.") (citations omitted).

187. See, e.g., *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1101-06 (9th Cir. 1999); *Condell v. Bress*, 983 F.2d 415, 417-20 (2d Cir. 1993); *Ass'n of Surrogates & Sup. Ct. Reporters v. New York (Surrogates I)*, 940 F.2d 766, 771-74 (2d Cir. 1991); *Chiles v. United Faculty of Fla.*, 615 So. 2d 671, 672-73 (Fla. 1993); *Ass'n of Surrogates & Sup. Ct. Reporters v. State*, 588 N.E.2d 51, 54 (N.Y. 1992); *In Re Quirk v. Regan*, 565 N.Y.S.2d 422, 424-25 (N.Y. Sup. Ct. 1991).

188. See, e.g., *Surrogates I*, 940 F.2d at 772 (describing the lag payroll scheme at issue in the case as having "the effect of withholding ten percent of each employee's expected wages over a period of twenty weeks and postponing their payment indefinitely").

These courts generally were reluctant to defer to such unilateral modifications since they directly served the financial interests of the governmental entity itself.<sup>189</sup>

The approach adopted in a majority of decisions is illustrated in *Association of Surrogates & Supreme Court Reporters Within the City of New York v. New York* (“*Surrogates I*”).<sup>190</sup> In 1989, the New York judiciary requested \$972.9 million in order to expand and better cope with the state’s “exploding drug crisis.”<sup>191</sup> The state, unfortunately, was also facing a budget deficit at the time.<sup>192</sup> The New York legislature reduced the judiciary’s budget request by \$69.1 million, but nevertheless approved the judiciary’s requested expansion.<sup>193</sup> In order to pay for the newly created positions, the legislature imposed a lag payroll scheme for certain non-judicial employees of the court system, which conflicted with the employees’ collective bargaining agreements.<sup>194</sup> The Second Circuit found that the impairment caused by the lag payroll was substantial, focusing on the effect it would have on individual employees.<sup>195</sup> The court refused to examine the

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189. *See supra* note 187.

190. 940 F.2d 766.

191. *Id.* at 769.

192. *Id.*

193. *Id.*

194. *Id.* The goal was to delay payment of employees’ salaries until two weeks after those salaries had been earned. In order to effectuate this plan, employees were paid for only nine days of the ten days worked in each pay period for ten two-week periods. By the end of the fiscal year, the affected employees were paid for fifty weeks’ work instead of fifty-two. The employees will be able to collect the withheld salary at the termination of their employment with the state at the rate of pay applicable to them at that time. *Id.*

195. *Id.* at 772.

For instance, a 25-year-old employee would not be repaid her lagged wages until she leaves the state’s employ—perhaps 45 years, should she devote her entire career to governmental service. The affected employees have surely relied on full paychecks to pay for such essentials as food and housing. Many have undoubtedly committed themselves to personal long-term obligations such as mortgages, credit cards, car payments, and the like—obligations which might go unpaid in the months that the lag payroll has its immediate impact.

*Id.*; *see also* *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1106 (9th Cir. 1999) (“Plaintiffs are wage earners, not volunteers. They have bills, child



governmental fiscal crisis without also regarding the “personal fiscal crises that the lag payroll would create.”<sup>196</sup>

The Second Circuit in *Surrogates I* also held that the lag payroll statute in question did not pass muster under the third prong of the *United States Trust* test, which asks whether the contractual impairment was “reasonable and necessary to serve an important public purpose.”<sup>197</sup> The *Surrogates I* court was skeptical of the necessity of a lag payroll plan during that year’s “perennial ‘fiscal cris[is].”<sup>198</sup> The court read the necessary requirement narrowly to mean that the impairment must be essential to implement the particular plan due to the absence of any other possible alternatives. The court found, however, there were alternatives to a lag payroll plan, albeit politically unpopular ones, like raising taxes or shifting money from other government programs.<sup>199</sup> The court ultimately concluded that the legislature had not shown it was necessary to “plac[e] the costs of improvements to the court system on the few shoulders of judiciary employees instead of the many shoulders of the citizens of the state.”<sup>200</sup>

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support obligations, mortgage payments, insurance premiums, and other responsibilities. Plaintiffs have the right to rely on the timely receipt of their paychecks. Even a brief delay in getting paid can cause financial embarrassment and displacement of varying degrees of magnitude.”); Opinion of the Justices, 609 A.2d 1204, 1210 (N.H. 1992) (“The bill under consideration here impairs the very heart of an employment contract: the promise of certain work for certain income. Its impact would likely wreak havoc on the finances of many of the affected workers and can only be considered substantial.”).

196. *Surrogates I*, 940 F.2d at 772.

197. *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 25 (1977); *Surrogates I*, 940 F.2d at 772-73.

198. *Surrogates I*, 940 F.2d at 774.

199. *Id.* at 773; see also *Chiles v. United Faculty of Fla.*, 615 So. 2d 671, 673 (“The mere fact that it is politically more expedient to eliminate all or part of the contracted funds is not in itself a compelling reason. Rather, the legislature must demonstrate that the funds are available from no other possible reasonable source.”); Opinion of the Justices, 609 A.2d at 1211 (“The legislature has many alternatives available to it, including reducing non-contractual State services and raising taxes and fees. Although neither of these choices may be as politically feasible as the furlough program, the State cannot resort to contract violations to solve its financial problems.”).

200. *Surrogates I*, 940 F.2d at 773. The court went on to query, “If a state government could so cavalierly disregard the obligations of its own contracts, of what value would its promises ever be?” *Id.* at 774.

A similar view prevailed in two cases challenging legislatively mandated furlough programs.<sup>201</sup> In *Massachusetts Community College Council v. Commonwealth*, the Massachusetts legislature responded to budgetary problems by requiring certain state employees to take a number of days off without pay.<sup>202</sup> State employee unions challenged the furlough program, claiming it violated various collective bargaining agreement provisions as well as the contract clause.<sup>203</sup>

In resolving the contract clause issue, the Supreme Judicial Court of Massachusetts focused on the “reasonableness” prong of the *United States Trust* test.<sup>204</sup> The court listed a number of factors to consider in undertaking a “reasonableness” analysis, including the extent of the impairment and the importance of the public purpose to be served.<sup>205</sup> The Court went on to explain:

An impairment is not a reasonable one if the problem sought to be resolved by an impairment of contract existed at the time the contractual obligation was incurred. If the foreseen problem has changed between the time of the contracting and the time of the attempted impairment, but has changed only in degree and not in kind, the impairment is not reasonable.<sup>206</sup>

In applying these factors, the court concluded that any difference in the state’s economic situation between the time the collective bargaining agreement was signed (December 1990) and the time the furlough program was implemented (April 1991) was a difference in degree and not a difference in kind.<sup>207</sup> The court therefore held the furlough program

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201. See *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012 (4th Cir. 1993); *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708 (Mass. 1995); see also *Opinion of the Justices*, 609 A.2d 1204. “[F]urloughs are mandatory time off work with no pay.” Michael Z. Green, *Unpaid Furloughs and Four-Day Work Weeks: Employer Sympathy or a Call for Collective Employee Action?* 42 CONN. L. REV. 1139, 1143 n.16 (2010) (quoting Susan M. Heathfield, *Employee Furloughs*, ABOUT.COM, <http://humanresources.about.com/od/glossary/f/g/furlough.htm> (last visited Oct. 27, 2010)).

202. *Mass. Cmty. Coll.*, 649 N.E.2d at 709.

203. *Id.* at 709-10.

204. *Id.* at 713.

205. *Id.* (citing *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 27, 29 (1977)).

206. *Id.* (citations omitted).

207. *Id.* at 716.

constituted a substantial impairment of state employees' rights under the collective bargaining agreements which could "not be justified as reasonable."<sup>208</sup>

The Fourth Circuit Court of Appeals took a distinctively different approach to the contract clause issue in *Baltimore Teachers Union v. Mayor of Baltimore*.<sup>209</sup> In that case, the Fourth Circuit found that Baltimore's furlough plan<sup>210</sup> constituted a substantial impairment of contract rights, but ultimately held that the plan was permissible as a legitimate exercise of the state's sovereign powers.<sup>211</sup>

The Fourth Circuit adopted a broader reading of the third prong of the *United States Trust* test, reasoning that "at least some deference to legislative policy decisions to modify these contracts in the public interest must be accorded."<sup>212</sup> Thus, according to the Fourth Circuit, the ability to raise taxes or shift funds from one governmental program to another does not automatically preclude a finding of necessity. "Were these the proper criteria," the court stated, "no impairment of a governmental contract could ever survive constitutional scrutiny, for these courses are always open, no matter how unwise they may be."<sup>213</sup>

The Fourth Circuit also found that the City tailored the plan as narrowly as possible to meet its unforeseen budget shortfall.<sup>214</sup> The City of Baltimore was required by law to balance its budget and faced a budget crisis which was exacerbated when \$24.2 million in state aid fell through.<sup>215</sup> Before enacting the furlough plan, Baltimore abandoned previously negotiated pay raises, and resorted to measures such as layoffs, job eliminations, and early retirement

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208. *Id.*

209. 6 F.3d 1012 (4th Cir. 1993).

210. "Under the plan, full-time city employees, except for firefighters . . . lost the annual equivalent of 2.5 days of pay, or .95% of their gross annual salary, and Baltimore saved approximately \$2 million, which it does not intend to refund." *Id.* at 1014.

211. *Id.* at 1015.

212. *Id.* at 1019.

213. *Id.* at 1020.

214. *Id.* at 1021.

215. *Id.* at 1020.

programs.<sup>216</sup> Only when the State proposed further cuts in state aid did the City resort to the furlough plan.<sup>217</sup> The court accordingly held that the plan was “necessary.”<sup>218</sup>

The court also held that the plan was “reasonable” considering the circumstances.<sup>219</sup> The plan was designed to “deal with a broad, generalized economic or social problem.”<sup>220</sup> The plan extended to all City employees as opposed to a narrow group such as in *Surrogates I*, and the plan was only temporary and was discontinued at the first opportunity.<sup>221</sup> Finally, the court noted that the plan “affected reliance interests not wholly unlike those of private entities in regulated industries, which contract subject to future, additional regulation.”<sup>222</sup> On this latter point, the court explained that “[p]ublic employees—federal or state—by definition serve the public and their expectations are necessarily defined, at least in part, by the public interest. It should not be wholly unexpected, therefore, that these public servants might well be called upon to sacrifice first when the public interest demands sacrifice.”<sup>223</sup>

#### D. *Legislative Modifications: The 2000s*

Three decisions in the last decade illustrate the continued diversity of approaches and outcomes in this area of law.

In *Buffalo Teachers Federation v. Tobe*, the Second Circuit Court of Appeals ruled that unilateral action imposed by a legislatively-created fiscal authority passed

216. *Id.*

217. *Id.* In this context, the court concluded that the furlough plan was a moderate course of action that was preferable to further layoffs. *See id.*

218. *See id.* at 1020-21.

219. *Id.* at 1021. The court noted that “the amount of the reduction was no greater than that necessary to meet the anticipated shortfall . . . [and] the plan did not alter pay-dependent benefits, overtime pay, hourly rates of pay, or the orientation of pay scales.” *Id.* at 1020.

220. *Id.* at 1021 (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 250 (1978)).

221. *Id.*

222. *Id.*

223. *Id.*

the *United States Trust* test.<sup>224</sup> Following a report of the state comptroller's office describing the City of Buffalo's fiscal woes, the New York state legislature passed an act establishing the Buffalo Fiscal Authority (the "Authority"), a public benefit corporation with delegated authority to impose wage and hiring freezes as may be essential to the maintenance of the City's long range financial plan.<sup>225</sup> After discovering a budget gap greater than previously estimated, in spite of having earlier instituted a freeze on hiring and non-contractual wage increases, the Authority froze the wages of all city employees, including those covered by collective bargaining agreements providing for future term wage increases.<sup>226</sup>

In considering the contract clause challenges instituted by several unions, the court initially addressed the level of deference due to the state where the employees whose contract rights were reduced were not on the payroll of the governmental entity that impaired those rights.<sup>227</sup> While the court declined to identify the precise level of deference due,<sup>228</sup> it noted that:

"Where economic or social legislation is at issue, some deference to the legislature's judgment is surely called for." . . . Nor is the heightened scrutiny to be applied as exacting as that commonly understood as strict scrutiny. Such a high level of judicial scrutiny of the legislature's actions would harken a dangerous return to the days of *Lochner v. New York* . . . .<sup>229</sup>

The court in *Buffalo Teachers Federation* went on to find that the contract impairment, although substantial in

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224. 464 F.3d 362, 371 (2d Cir. 2006).

225. *See id.* at 365-66.

226. *See id.* at 366-67.

227. The defendants argued that their actions should be afforded substantial deference because the state did not impair one of its own obligations. *See id.* at 369-70. The plaintiffs, on the other hand, argued for a less deferential standard on the grounds that the wage freeze was a self-serving measure that would reduce the need for future amounts of state aid. *See id.* at 370.

228. The court stated that it would "assume that the lower level of deference applies because . . . the wage freeze is reasonable and necessary even under the less deferential standard." *Id.*

229. *Id.* at 370-71 (citing Local Div., 589, Amalgamated Transit Union v. Massachusetts, 666 F.2d 618, 643 (1st Cir. 1981)).

nature,<sup>230</sup> was nonetheless reasonable under the circumstances.<sup>231</sup> The court found that the wage freeze was a “last resort” measure that was taken only after other measures such as hiring freezes, school closings, and layoffs failed to close the budgetary gap.<sup>232</sup> The court was also influenced by the “temporary and prospective nature of the wage freeze.”<sup>233</sup> Even though the Authority’s action suspended wage increases provided for in existing bargaining agreements, the court found it significant that “[t]he impairment here does not affect past salary due for labor already rendered . . . .”<sup>234</sup>

Turning to the “necessary” prong of the *United States Trust* test, the court rejected the union’s argument that tax increases offered an available alternative to the Authority’s action.<sup>235</sup> The court stated the City had already raised taxes and that raising taxes should not be the only permissible response.<sup>236</sup> Significantly, the court gave substantial deference to the governmental decision, stating, “we find no need to second-guess the wisdom of picking the wage freeze over other policy alternatives . . . .”<sup>237</sup> Finally, the court distinguished its earlier *Surrogates I* decision on the grounds that, unlike the earlier case, “no one questions the existence of a very real fiscal emergency in Buffalo.”<sup>238</sup>

In a second case decided in 2008, the Eighth Circuit Court of Appeals ruled that the City of Benton, Arkansas violated the contract clause when it unilaterally reduced health care premiums for retired city employees.<sup>239</sup> Pursuant to a collective bargaining agreement, the City was

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230. *See id.* at 368 (“The promise to pay a sum certain constitutes not only the primary inducement for employees to enter into a labor contract, but also the central provision upon which it can be said they reasonably rely.”).

231. *Id.* at 370-71.

232. *Id.* at 371.

233. *Id.*

234. *Id.* at 372.

235. *Id.*

236. *Id.*

237. *Id.*

238. *Id.* at 373.

239. *AFSCME, Local 2957 v. City of Benton*, 513 F.3d 874, 877, 882 (8th Cir. 2008).

obligated to pay the full cost of health insurance premiums for retirees.<sup>240</sup> During the term of the agreement, the City Council passed a resolution reducing the City's premium contributions.<sup>241</sup> The Eighth Circuit rejected the City's argument that the unilateral modification was legitimately predicated on concerns of "economic necessity."<sup>242</sup> The court explained:

Although economic concerns can give rise to the City's legitimate use of the police power, such concerns must be related to "unprecedented emergencies," such as mass foreclosures caused by the Great Depression. Further, to survive a challenge under the Contract Clause, any law addressing such concerns must deal with a broad, generalized economic or social problem.<sup>243</sup>

The court concluded that the City's evidence of economic necessity fell short of establishing the existence of an "unprecedented emergency" or a "broad economic problem" sufficient to warrant the City's unilateral action.<sup>244</sup>

The federal district court for Maryland reached a similar outcome in a case decided the following year. In *Fraternal Order of Police v. Prince George's County*, the court struck down a County's furlough plan that unilaterally reduced work schedules by eighty hours.<sup>245</sup> The court found that this reduction substantially impaired several union contracts by imposing a 3.85% cut in annual pay.<sup>246</sup> In terms of the "reasonableness" inquiry, the court expressed doubts about whether the County's revenue shortfalls were truly unforeseen and also found that neither the magnitude nor timing of the shortfalls were as severe as that faced by the City of Baltimore in the earlier *Baltimore Teachers Union* case.<sup>247</sup> The court also ruled that the

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240. *Id.* at 877.

241. *Id.*

242. *Id.* at 882.

243. *Id.* (citations omitted).

244. *Id.*

245. See *Fraternal Order of Police v. Prince George's Cnty.*, 645 F. Supp. 2d 492, 501, 518-19 (D. Md. 2009), *rev'd*, 608 F.3d 183 (4th Cir. 2010).

246. *Id.* at 510.

247. See *id.* at 514-15; see also *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1020 (4th Cir. 1993).

furlough plan was not “necessary” since the County had several more moderate alternatives available, such as tapping undesignated fund balances, restricting real estate and equipment purchases, and spreading the financial retrenchment more broadly.<sup>248</sup> In the latter regard, the court expressed the following concern about the narrowly targeted nature of the furlough plan:

[T]he County demonstrated its appreciation of the importance of contracts when it acknowledged that “[they] were bound by an agreement with the State of Maryland” and therefore could not implement any budget cuts for Prince George’s County Hospital. The County appears to have preconceived notions about the lines it will and will not cross in order to accomplish its objectives.<sup>249</sup>

The Fourth Circuit Court of Appeals reversed in a 2010 decision.<sup>250</sup> The Fourth Circuit’s opinion does not take issue with the lower court’s assessment of the reasonable and necessary factors, but instead found that the County’s furlough plan did not operate as an impairment of contract.<sup>251</sup> The Fourth Circuit construed the collective bargaining agreements at issue as incorporating the County’s Personnel Law, which expressly authorizes the adoption of a furlough plan upon the County Executive’s determination that such a plan is required in order to respond to an ascertained shortfall in revenue.<sup>252</sup> The Fourth Circuit therefore concluded that since the furlough plan was authorized by the collective agreements, no impairment resulted and an analysis of the reasonable and necessary factors was not required.<sup>253</sup>

## V. CRITICAL ANALYSIS

This Part more closely examines the contract clause/unilateral change jurisprudence in three respects. First, this Part identifies those factual issues that the

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248. See *Fraternal Order of Police*, 645 F. Supp. 2d at 515-17.

249. *Id.* at 516 (citation omitted).

250. *Fraternal Order of Police Lodge No. 89 v. Prince George’s Cnty.*, 606 F.3d 183, 193 (4th Cir. 2010).

251. *Id.* at 188-89.

252. *Id.* at 190-91.

253. See *id.* at 188-89.



courts have most heavily relied upon in deciding the contract clause issue. Second, this Part critiques the legal analysis used by the courts with particular emphasis on those decisions which have rejected contract clause challenges. Finally, this Part concludes by suggesting an analytical framework for addressing such cases in the future.

A. *The Most Significant Factual Issues*

Contract clause analysis under the *United States Trust* standard is a fact-intensive endeavor. In addition to determining whether a substantial impairment of contract has occurred, the test requires a careful balancing of factors relating to whether such an impairment was reasonable and necessary under the circumstances.<sup>254</sup> Because of the many factors that are potentially relevant to this analysis, it is often difficult to predict whether a contemplated legislative modification will pass constitutional muster. This Section attempts to enhance predictability by identifying those factual issues that the courts find most significant to their determinations.

1. *The Severity of the Fiscal Emergency.* Courts frequently place great weight on the severity of the fiscal problems confronting a public employer. For example, in comparing the two earliest legislative modifications in this set of cases, the Supreme Court of California, in finding a contract clause violation, placed emphasis on the finding that California's fiscal crisis at issue in *Sonoma County Public Employees* was less severe than that experienced by New York City in *Subway-Surface Supervisors*.<sup>255</sup> Viewing the comparison through the opposite lens, the Second Circuit in *Buffalo Teachers Federation* contrasted the doubtful 1990 emergency of *Surrogates I* with "the very real [2004] fiscal emergency in Buffalo."<sup>256</sup> For these courts, the

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254. See *supra* notes 184-86 and accompanying text.

255. See *Sonoma Cnty. Org. of Pub. Emps. v. Cnty. of Sonoma*, 591 P.2d 1, 9-11 (Cal. 1979).

256. *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 373 (2d Cir. 2006).

greater the fiscal emergency, the more likely that a legislative modification will be upheld.<sup>257</sup>

2. *Foreseeability*. An oft-cited factor in contract clause decisions is whether the government's economic problem was foreseeable or an "unprecedented emergency."<sup>258</sup> As explained by the Supreme Judicial Court of Massachusetts:

An impairment is not a reasonable one if the problem sought to be resolved by an impairment of a contract existed at the time the contractual obligation was incurred. If the foreseen problem has changed between the time of the contracting and the time of the attempted impairment, but has changed only in degree and not in kind, the impairment is not reasonable.<sup>259</sup>

In contrast, a surprise budgetary emergency, such the unanticipated loss of state aid in *Baltimore Teachers Union*, is more likely to justify an impairment as a "reasonable" measure.<sup>260</sup>

3. *The Substantiality of the Impairment*. The severity issue is also important with respect to the nature and extent of the legislative modification. Under the United States Trust standard, a contract clause violation can be established only if it is shown that a substantial impairment of contract rights has occurred.<sup>261</sup>

Courts have little difficulty finding such an impairment where legislative action reduces or eliminates compensation promised in a collective bargaining agreement.<sup>262</sup> Such action abridges a right that that likely "induced the parties

257. See *Carlstrom v. State*, 694 P.2d 1, 5 (Wash. 1985) (suggesting that an impairment of contract is permissible if health or safety considerations, and not just financial considerations, are implicated).

258. *AFSCME v. City of Benton*, 513 F.3d 874, 882 (8th Cir. 2008).

259. *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708, 713 (Mass. 1995) (citation omitted); see also *Carlstrom*, 694 P.2d at 5 (finding that the state was "fully aware of its financial problems" during negotiations and prior to signing the contract).

260. See *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1014, 1017-18 (4th Cir. 1993).

261. See *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 17-21 (1977).

262. See, e.g., *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006); *Sonoma Cnty. Org. of Pub. Emps. v. Cnty. of Sonoma*, 591 P.2d 1, 4, 7 (Cal. 1979); *Carlstrom*, 694 P.2d at 4-6.

to enter into the contract”<sup>263</sup> initially and goes to “the very heart of an employment contract.”<sup>264</sup> The First Circuit Court of Appeals, on the other hand, found no contract clause violation when the legislative action altered only the process for establishing terms and conditions of employment rather than the substantive terms of the employment relationship.<sup>265</sup>

Falling in between these extremes are measures such as furloughs and pay-lag schemes. Here, the terms of the particular collective bargaining agreement may be determinative as to whether such action constitutes an impairment. While a number of courts have found substantial impairments where such measures reduce the agreed upon level of compensation or hours,<sup>266</sup> the Fourth Circuit ruled that a unilaterally imposed furlough does not constitute an impairment where the terms of the parties’ agreement implicitly authorized such action.<sup>267</sup>

4. *Availability of Alternatives.* The courts almost uniformly indicate that the availability of alternatives to contract impairment is an important consideration,<sup>268</sup> but they do not uniformly agree as to what measures constitute appropriate alternatives.<sup>269</sup> The major area of disagreement

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263. *Balt. Teachers Union*, 6 F.3d at 1018.

264. Opinion of the Justices, 609 A.2d 1204, 1210 (N.H. 1992).

265. Local Div. 589, Amalgamated Transit Union v. Massachusetts, 666 F.2d 618, 640 (1st Cir. 1981).

266. See, e.g., *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1106 (9th Cir. 1999) (lag payroll); *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708, 709-10 (Mass. 1995) (furlough).

267. *Fraternal Order of Police Lodge No. 89 v. Prince George's Cnty.*, 606 F.3d 183, 188-89 (4th Cir. 2010).

268. See, e.g., *Chiles v. United Faculty of Fla.*, 615 So. 2d 671, 673 (Fla. 1993). (“[T]he legislature must demonstrate that the funds are available from no other possible reasonable source.”); Thomas H. Lee, Jr., *Baltimore Teachers Union v. Mayor of Baltimore: Does the Contract Clause Have Any Vitality in the Fourth Circuit?*, 72 N.C. L. REV. 1633, 1647 (1994) (stating that the Supreme Court in *United States Trust* “established a presumption in favor of alternatives that did not impair public contracts.”).

269. Courts sustaining contract clause challenges have found that legislative bodies erred by not considering such alternatives as reducing non-contractual services and tapping undesignated reserve funds. See *Fraternal Order of Police v. Prince George's Cnty.*, 645 F. Supp. 2d 492, 515-17 (D. Md. 2009), *rev'd on*

concerns whether the possibility of raising taxes should be considered as an alternative or not. While some courts have adopted an affirmative position,<sup>270</sup> two other courts have declined to view raising taxes as a preferential alternative.<sup>271</sup> As the Fourth Circuit stated in *Baltimore Teachers Union*, if raising taxes or shifting funds between programs were considered to be viable alternatives, “no impairment of a governmental contract could ever survive constitutional scrutiny, for these courses are always open, no matter how unwise they may be.”<sup>272</sup>

While the tax increase alternative is unclear, the importance of a governmental unit resorting to alternate measures prior to abrogating a collective agreement is not. Public bodies that implement alternative measures such as hiring freezes, layoffs, program closures, and early retirement incentives are more likely to withstand contract clause challenges if they subsequently impair contract terms.<sup>273</sup> In this context, prior resort to meaningful alternatives that do not alleviate the fiscal crises provides governmental defendants with the plausible argument that the contract impairment was a necessary action of “last resort.”<sup>274</sup>

5. *Timing.* Temporal considerations come into play in two ways. First, courts react more favorably to impairments that operate only in a prospective fashion. Thus, a measure that alters pay or hours going forward is more likely to be upheld than one that eliminates compensation already earned.<sup>275</sup> Two decisions have even applied this principle to sustain the elimination of future

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*other grounds*, 608 F.3d 183 (4th Cir. 2010); *Opinion of the Justices*, 609 A.2d at 1211.

270. See *Ass’n of Surrogates & Sup. Ct. Reporters v. New York (Surrogates D)*, 940 F.2d 766, 773 (2d Cir. 1991); *Opinion of the Justices*, 609 A.2d at 1211.

271. See *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 372 (2d Cir. 2006); *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1019-20 (4th Cir. 1993).

272. *Balt. Teachers Union*, 6 F.3d at 1020.

273. See *id.* at 1019-20.

274. *Buffalo Teachers Fed’n*, 464 F.3d at 371.

275. See *id.* at 371-72; *Subway-Surface Supervisors Ass’n v. N.Y. City Transit Auth.*, 375 N.E.2d 384, 390-91 (N.Y. 1978).

wage increases provided by the terms of an already executed collective bargaining agreement.<sup>276</sup> Second, courts are less offended by temporary as opposed to permanent modifications. A court, accordingly, is more likely to uphold a measure that defers wage increases than a measure that eliminates them.<sup>277</sup> Similarly, the Fourth Circuit has commented favorably on the fact that a governmental unit discontinued its furlough plan “at the first opportunity.”<sup>278</sup>

6. *Sharing the Pain.* Courts are less likely to uphold a legislative modification where it appears that a target group of employees are bearing a disproportionate share of the burden occasioned by the fiscal crisis.<sup>279</sup> Thus, the Second Circuit in *Surrogates I* was skeptical of a modification that “plac[ed] the costs of improvements to the court system on the few shoulders of judiciary employees instead of the many shoulders of the citizens of the state.”<sup>280</sup> The federal district court in *Fraternal Order of Police* also expressed concern that the County’s furlough plan was not accompanied by a broader plan of financial retrenchment.<sup>281</sup> In contrast, the contract modification sustained in *Buffalo Federation of Teachers* was mirrored by a broad array of other budget-cutting measures.<sup>282</sup> Not all courts, however, agree about the need for spreading the pain. As the Fourth

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276. See *Buffalo Teachers Fed’n*, 464 F.3d at 371-72; *Subway-Surface Supervisors*, 375 N.E.2d at 390-91.

277. See *Sonoma Cnty. Org. of Pub. Emps. v. Cnty. of Sonoma*, 591 P.2d 1, 9 (Cal. 1979) (comparing unfavorably the eliminated wage increase at issue with the deferred increase in *Subway-Surface Supervisors*). But see *Ass’n of Surrogates & Sup. Ct. Reporters v. New York (Surrogates I)*, 940 F.2d 766, 772 (2d Cir. 1991) (invalidating a pay-lag deferral scheme whereby an employee would not be repaid lagged wages until termination of employment).

278. *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1021 (4th Cir. 1993).

279. See, e.g., *Condell v. Bress*, 983 F.2d 415, 419 (2d Cir. 1993) (“[P]lacing the burden of coping with a fiscal crisis on the shoulders of only a few people . . . is less fair than ‘spreading the pain’ among many. We agree that the number of people involved is one factor to be considered on the issue of ‘reasonable and necessary’ . . .”) (citation omitted).

280. *Surrogates I*, 940 F.2d at 773.

281. See *Fraternal Order of Police v. Prince George’s Cnty.*, 645 F. Supp. 2d 492, 516 (D. Md. 2009), *rev’d on other grounds*, 608 F.3d 183 (4th Cir. 2010).

282. See *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 371 (2d Cir. 2006).

Circuit stated in *Baltimore Teachers Union*, “public servants might well be called upon to sacrifice first when the public interest demands sacrifice.”<sup>283</sup>

### B. *Analytical Shortcomings*

The factual issues discussed in the preceding section explain many, but not all, of the public sector contract clause decisions. In addition to distinctions in fact, the cases also illustrate distinctions in analytical approach. In particular, several of the decisions upholding legislative modifications appear to adopt approaches that depart from the standards enunciated in the *United States Trust* decision.

1. *Level of Deference.* While courts traditionally have given considerable deference to legislative policy judgments in deciding most types of contract clause cases,<sup>284</sup> the Supreme Court in *United States Trust* determined that such deference is not appropriate where the legislative body has impaired one of its own contracts.<sup>285</sup> In this context, the Court stated that “complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State’s self-interest is at stake.”<sup>286</sup> As such, the Court cautioned that “a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives.”<sup>287</sup>

Most public sector contract clause decisions have properly applied the standard of deference established in the *United States Trust* decision.<sup>288</sup> In *Massachusetts Community College Council*, for example, the Supreme Judicial Court of Massachusetts noted that a “stricter

283. *Balt. Teachers Union*, 6 F.3d at 1021.

284. See Thompson, *supra* note 130, at 1457-59.

285. See *United States Trust Co. v. New Jersey*, 431 U.S. 1, 26, 30 (1977).

286. *Id.* at 26.

287. *Id.* at 30-31.

288. See Ronald D. Wenkart, *Unilateral Modification of Collective Bargaining Agreements in Times of Fiscal Crisis and Bankruptcy: An Unconstitutional Impairment of Contract?*, 225 EDUC. L. REP. 1, 19 (2007) (“Even in cases of extreme fiscal crisis . . . the courts have been reluctant to modify or repeal the provisions of collective bargaining agreements.”).

scrutiny” was required in testing the abrogation of a governmental entity’s own contractual obligations.<sup>289</sup>

In several decisions in which legislation modifications were sustained, however, courts appeared to give more deference than contemplated under the *United States Trust* decision. At least three courts have expressly stated that, despite the less deferential approach described in *United States Trust*, legislative modifications of public sector obligations deserve at least “some deference” when challenged on contract clause grounds.<sup>290</sup> While this articulation might not seem to be necessarily inconsistent with *United States Trust* at first blush, these decisions, in practice, almost completely have deferred to the legislature’s assessment on the reasonable and necessary issues.<sup>291</sup> As an example, although the New York court in *Subway-Surface Supervisors* invoked the *United States Trust* standard by name, the court did not examine independently the foreseeability of the fiscal crisis or the availability of alternatives less drastic than the elimination of contractual wage increases.<sup>292</sup>

An apparent concern with literal application of the *United States Trust* standard is that, in the words of the Fourth Circuit in *Baltimore Teachers Union*, such application would compel the courts to sit as “superlegislatures,” second-guessing legislative policy

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289. *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708, 711 (Mass. 1995).

290. *See* *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1019 (4th Cir. 1993); *Local Div., 589, Amalgamated Transit Union v. Massachusetts*, 666 F.2d 618, 642 (1st Cir. 1981); *Subway-Surface Supervisors Ass’n v. N.Y. City Transit Auth.*, 375 N.E.2d 384, 390 (N.Y. 1978); *see also* *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 370 (2d Cir. 2006) (“less deference does not imply no deference”).

291. *See* *Lee*, *supra* note 268 at 1642, 1648 (concluding that the courts in the *Local Division 589* and *Baltimore Teachers Union* decisions almost completely deferred to the governmental bodies abrogating contract obligations).

292. *See* *Subway-Surface Supervisors*, 375 N.E.2d at 388-91. Instead, the court simply affirmed the legislature’s finding that a fiscal emergency existed, stating, “[h]ere, little deference is required, when the circumstances themselves so clearly demonstrate that the Legislature’s conclusion was a valid one.” *Id.* at 390. Although this assessment may have been factually accurate, the existence of a budgetary emergency does not itself justify impairment under the *United States Trust* test.

determinations.<sup>293</sup> As the Second Circuit summarized in *Buffalo Teachers Federation*:

“Where economic or social legislation is at issue, some deference to the legislature’s judgment is surely called for.” . . . Nor is the heightened scrutiny to be applied as exacting as that commonly understood as strict scrutiny. Such a high level of judicial scrutiny of the legislature’s actions would harken a dangerous return to the days of *Lochner v. New York*. . . .<sup>294</sup>

It is true that courts in the post-*Lochner* era do not undertake a *de novo* review of legislation on substantive due process grounds. In this realm, a legislative body’s enactment of economic and social legislation in furtherance of its police power is entitled to considerable deference.<sup>295</sup>

A more apt analogy in this context, however, may be drawn to jurisprudence under the Equal Protection Clause. Here, the United States Supreme Court has created a method of analyzing the legitimacy of legislative enactments based on the identity of the group classification embodied in the legislation. Under the Court’s analytical framework, the intensity of scrutiny correlates with the likelihood that the state has singled out for unfavorable treatment a group that is unable to protect itself in the political process or that has traditionally faced discrimination.<sup>296</sup> The Court considers several factors to determine when a legislative classification warrants more stringent levels of judicial protection: (1) whether the class is identified by an immutable characteristic; (2) whether the class has a long history of suffering from invidious

293. *Balt. Teachers Union*, 6 F.3d at 1021; see also *Local Div. 589*, 666 F.2d at 642 (interpreting *United States Trust* as not requiring courts to reexamine *de novo* all of the factors underlying legislative judgments).

294. *Buffalo Teachers Fed’n*, 464 F.3d at 370-71 (quoting *Local Div. 589*, 666 F.2d at 643); see also *Lochner v. New York*, 198 U.S. 45 (1905).

295. See generally LAWRENCE TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 16-2 (2d ed. 1988).

296. In its famous footnote 4 in *United States v. Carolene Products Co.*, the Court laid the foundation for its modern equal protection jurisprudence, observing that “discrete and insular minorities” may be unable to secure legislative protection for their interests and thus are more likely to be victims of state-sponsored discrimination. 304 U.S. 144, 152-53 n.4 (1938). For this reason, the Court suggested that courts should act to protect the interests of such minorities by closely scrutinizing state laws and policies. *Id.*



discrimination; and (3) whether the class is relatively politically powerless.<sup>297</sup> Based on these factors, the Court has identified three different levels of review: (1) strict scrutiny for governmental action affecting suspect classes; (2) intermediate scrutiny with respect to quasi-suspect classes; and (3) rational basis review for all other governmental classifications.<sup>298</sup>

Where a public employer intentionally discriminates on the basis of race, or has a statute or policy in place that makes a racial classification, the classification is subject to strict scrutiny and the state must show that its decision is narrowly tailored to serve a compelling government interest.<sup>299</sup> In contrast, the “quasi-suspect” classes—those classifications based on gender and illegitimacy—are subject to intermediate scrutiny, which asks whether a public employer’s decision serves “important governmental objectives and [is] substantially related to achievement of those objectives.”<sup>300</sup> All other classifications—including those based on age, disability, sexual orientation, and religion—receive rational basis review which asks merely whether a challenged policy or practice is reasonably related to a valid state interest.<sup>301</sup>

A similar sliding scale approach is appropriate with respect to contract clause analysis. For the vast majority of legislatively-imposed contract impairments, the courts generally should defer to the economic and social judgment of the legislative body in a manner similar to rational basis review. But that broad level of deference is not appropriate for circumstances in which the motive of the legislative body is suspect, such as when the legislative body is impairing its own contractual obligation. In this context, the legislative impairment is as likely to represent a convenient avoidance of the governmental unit’s own obligation as it is to represent a step that is reasonable and necessary to safeguard societal interests. In this narrow set of

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297. See *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 28 (1973); *Frontiero v. Richardson*, 411 U.S. 677, 686-88 (1973).

298. See generally *TRIBE*, *supra* note 295, at §§ 16-3 to -6.

299. See *City of Cleburne v. Cleburne Living Ctr., Inc.*, 473 U.S. 432, 440 (1985).

300. *Craig v. Boren*, 429 U.S. 190, 197 (1976).

301. See *Padula v. Webster*, 822 F.2d 97, 102 (D.C. Cir. 1987).

circumstances, a more searching, less deferential inquiry into legislative purpose is warranted. While a requirement of strict scrutiny may go too far, a requirement that a legislative body must show that a self-impairment is reasonable and necessary to serve “important governmental objectives” is consistent with *United States Trust*.

2. *Public Sector Collective Bargaining Agreements Differ from “Real” Contracts.* A second analytic flaw embraced by some courts is to view public sector collective bargaining agreements as less worthy of protection than other types of contracts. The decision of the New York Court of Appeals in *Subway-Surface Supervisors* illustrates this viewpoint. In that case, the court upheld the rescission of a 5% wage increase provided for the second year of a two-year collective bargaining agreement.<sup>302</sup> In doing so, the court contrasted the contract rights of the transit workers covered by the collective agreement with the contract rights of municipal bondholders who previously had been accorded preferential treatment by the City.<sup>303</sup> The court noted that the elimination of the wage increases was merely prospective in nature, since the increases had not yet been earned and were not vested since the employees had the right to quit in response to the legislative modification.<sup>304</sup> In contrast, the court found the bondholders’ rights to be superior since those rights already had vested and the impairment of those rights would have had a greater detrimental impact by worsening the City’s credit rating.<sup>305</sup>

The concept of vesting relied on by the New York court in *Subway-Surface Supervisors* mistakenly views future compensation established in a collective bargaining agreement through the lens of legislative powers rather than as a contractual obligation. Although employee compensation in the absence of collective bargaining is conferred voluntarily by a governmental employer, and a property right arises only upon an employee’s

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302. *Subway-Surface Supervisors Ass’n v. N.Y. City Transit Auth.*, 375 N.E.2d 384, 387 (N.Y. 1978); *see also supra* notes 162-68 and accompanying text.

303. *Subway-Surface Supervisors*, 375 N.E.2d at 391.

304. *Id.* at 390-91.

305. *Id.* at 391.

performance,<sup>306</sup> the introduction of public sector collective bargaining changes both the nature and timing of the employee's property interest. That interest is now governed by contract and not simply by the unilateral will of the governmental entity. As the Supreme Court of California explained in *Sonoma County Public Employees*, a multiple-year collective bargaining agreement constitutes an indivisible contractual whole for which employees render consideration from the contract's inception.<sup>307</sup> The New York court thus failed to recognize that the contract itself, once validly executed and ratified, gives rise to a vested obligation for the duration of the contract term.<sup>308</sup>

Equally as troubling is the New York court's view that public sector bargaining agreements are less deserving of protection than are other types of contracts.<sup>309</sup> The court's comparison of the respective rights of public employees and municipal bondholders, in addition to its skewed view as to vesting, inappropriately transforms public sector collective bargaining agreements into second-class contractual obligations.

3. *Extra Loyalty*. In a related vein, some courts upholding legislative modifications view public employees as owing special obligations to their governmental employers. The best example of this phenomenon is

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306. See, e.g., *Personnel Div. v. St. Clair*, 498 P.2d 809, 811 (Or. Ct. App. 1972).

307. See *Sonoma Cnty. Org. of Pub. Emps. v. Cnty. of Sonoma*, 591 P.2d 1, 10 (Cal. 1979). The court stated:

[W]e seriously question the New York court's rationale. A contract must be viewed as a whole; it cannot be fractured into isolated components. The anticipated wage increases during the second year thereof may have affected the employees' wage demands for the first year of the contract, and undoubtedly many employees rendered their services in the first year in anticipation of their contractual right to the second year increase. It is doubtful, therefore, that the New York court was correct in its conclusion that the employees had not rendered consideration for the second year of the contract when the freeze was imposed.

*Id.* at 10.

308. See *Labor Relations Comm'n v. Bd. of Selectmen*, 373 N.E.2d 1165, 1171 (Mass. 1978).

309. See *Subway-Surface Supervisors*, 375 N.E.2d at 390-91.

provided in *Baltimore Teachers Union*, in which the Fourth Circuit Court of Appeals upheld a furlough plan that impaired the provisions of several collective bargaining agreements.<sup>310</sup> The Fourth Circuit noted that the furlough plan “affected reliance interests not wholly unlike those of private entities in regulated industries, which contract [is] subject to future, additional regulation.”<sup>311</sup> The court went on to state: “[p]ublic employees—federal or state—by definition serve the public and their expectations are necessarily defined, at least in part, by the public interest. It should not be wholly unexpected, therefore, that these public servants might well be called upon to sacrifice first when the public interest demands sacrifice.”<sup>312</sup>

The notion advanced by the Fourth Circuit is that public employees owe a special fealty by virtue of their employment such that they may be required to bear a greater proportional burden when a governmental entity seeks to respond to a fiscal crisis. The court’s comparison of the respective rights of public employees and municipal bondholders is reminiscent of the paternalistic and largely discredited “extra loyalty” doctrine.<sup>313</sup> The Fourth Circuit’s focus on the appropriateness of public employee sacrifices is also inconsistent with the concept of spreading the burden of fiscal problems widely among affected groups.<sup>314</sup> Ultimately, the Fourth Circuit’s approach provides a disquieting justification for treating public employees, like their contracts, as second-class citizens.<sup>315</sup>

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310. *Balt. Teachers Union v. Mayor of Balt.*, 6 F.3d 1012, 1022 (4th Cir. 1993); *see also* notes 209-23 and accompanying text.

311. *Balt. Teachers Union*, 6 F.3d at 1021.

312. *Id.*

313. *See supra* note 16 and accompanying text.

314. *See supra* notes 279-81 and accompanying text; *see also* Lee, *supra* note 268, at 1653 (“Equity demands that the whole city, not just its employees, carry the burden of the fiscal crisis.”).

315. *See* Alan Miles Ruben, *The Top Ten Judicial Decisions Affecting Labor Relations in Public Education During the Decade of the 1990’s: The Verdict of Quiescent Years*, 30 J.L. & EDUC. 247, 250 (2001) (“The Fourth Circuit’s decision illustrates, once again, that when times are tough and government coffers depleted, the assumed security of public school employment may be illusory, and lends credence to the cynical notion that public employees are second class citizens whose interests can be sacrificed for political considerations.”); *see also*

### C. *A Suggested Framework*

The preceding discussion of significant factual issues and analytic shortcomings begs one final question: What should be the appropriate analytic framework for resolving contract clause challenges to legislative modifications of collective bargaining agreements? After sifting through these various considerations, the following four-factor framework is recommended.

1. *Heightened Scrutiny*. As the Supreme Court stated in *United States Trust*, “complete deference to a legislative assessment of reasonableness and necessity is not appropriate [where] the State’s self-interest is at stake.”<sup>316</sup> Because such an impairment occurs in a context where the motives of the governmental actor are suspect, something more than rational basis judicial review is warranted. An appropriate standard is provided by analogy to intermediate scrutiny under the Equal Protection Clause.<sup>317</sup> Thus, in reviewing a legislative body’s impairment of a collective bargaining agreement, a court should undertake a *de novo* review to determine if the impairment was an action that was reasonable and necessary to serve an important government purpose.

2. *A Reasonable Response to an Unanticipated Emergency*. The Supreme Court in *United States Trust* focused on foreseeability as the key to the reasonableness inquiry.<sup>318</sup> In that case, the Court found that the abrogation of a covenant due to financial concerns was not reasonable where the likelihood of substantial future deficits was well known at the time of the covenant’s adoption.<sup>319</sup> Thus, to be reasonable, a contract impairment must be in response to

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Stephen J. McGarry, *Public Sector Collective Bargaining and the Contract Clause*, 31 LAB. L.J. 67, 73 (1980) (concluding that the New York court’s decision in *Subway-Surface Supervisors* “comes suspiciously close” to the previous notion that public employees “owe a duty of ‘extra loyalty’ which no other group owes to the state”).

316. *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 26 (1977).

317. *See supra* pp. 47-48.

318. *See U.S. Trust Co.*, 431 U.S. at 31-32.

319. *See id.*

an emergency that was unforeseeable at the time the contractual obligation was incurred, or where a foreseeable problem morphs into an emergency that is different in kind and not just degree.<sup>320</sup> Finally, a reasonable impairment is one that is rationally and minimally tailored to address the problem at issue.<sup>321</sup>

3. *Modification Found Necessary After a Full Exploration of Alternatives.* In *United States Trust*, the Supreme Court stated that “a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives.”<sup>322</sup> At a minimum, this language means that a governmental body, in order to justify impairing one of its own contractual obligations, must demonstrate that it first considered other alternatives in good faith. It also means that such an impairment will not be allowed under the contract clause unless the governmental body that implemented the impairment had reasonable grounds for failing to resort to other alternatives.

4. *A Program of Shared Pain.* As a corollary to the third factor, courts generally should not uphold a governmental entity’s modification of one of its own contracts unless it is part of a plan that distributes the burden of coping with fiscal crisis broadly and equitably.<sup>323</sup> This requirement serves three related purposes. First, such a plan is evidence that the governmental entity considered the various alternatives to contract abrogation. Second, the development of such a plan serves to undercut the suspicion that a public entity’s impairment of one of its own contracts is self-serving in nature. Finally, the plan may serve to demonstrate that the impairment is reasonable and

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320. See *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708, 713 (Mass. 1995).

321. See *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 371-72 (2d Cir. 2006) (upholding legislative modification where impairment was temporary and prospective in nature).

322. *U.S. Trust Co.*, 431 U.S. at 30-31.

323. See *supra* notes 279-81 and accompanying text.

necessary as a “last resort” means of dealing with a fiscal emergency.<sup>324</sup>

This framework faithfully implements the standards and policies of the *United States Trust* decision. Pursuant to this approach, governmental entities generally should not be able to renege on their own agreements—whether established by collective bargaining or otherwise—as a matter of economic expedience. Instead, courts should carefully review self-serving abrogations to determine if they truly are reasonable and necessary to serve an important government purpose. The Supreme Court’s *United States Trust* decision, however, also recognized the need for a safety valve in the public interest.<sup>325</sup> Thus, when a governmental entity—such as the Buffalo Fiscal Authority in *Buffalo Teachers Federation*—responds to an unanticipated financial emergency by a broad plan of shared pain that includes the impairment of a collectively bargained wage increase, the impairment may be upheld as a necessary and lawful component of that plan.<sup>326</sup>

#### CONCLUSION

As public sector budgets have waxed and waned in response to changes in the economic cycle, public sector managers over the past thirty years have repeatedly faced periods of fiscal crisis. With personnel costs constituting a major component of these budgets, public sector employers increasingly have sought to control costs by resorting to measures such as wage freezes and furloughs.<sup>327</sup>

The prerogative of governmental entities to set compensation and hours, however, becomes more limited when such terms and conditions of employment are governed by collective bargaining agreements. A system of collective bargaining transforms such topics from matters of

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324. See *Buffalo Teachers Fed’n*, 464 F.3d at 371 (finding wage freeze to be a necessary “last resort” after other budgetary measures failed to resolve the City of Buffalo’s fiscal crisis).

325. See *U.S. Trust Co.*, 431 U.S. at 25 (“[A]n impairment may be constitutional if it is reasonable and necessary to serve an important public purpose.”).

326. See *Buffalo Teachers Fed’n*, 464 F.3d at 371-72.

327. See *supra* notes 54-58 and accompanying text.

unilateral employer authority to matters subject to bilateral determination. In the latter context, an employer's unilateral alteration of contract terms without bargaining is unlawful. This is a core principle of both private and public sector labor relations.

A significant point of departure for the two sectors occurs when a legislative body, such as a state legislature, enacts legislation that has the effect of modifying the terms of a public sector collective bargaining agreement. If the legislative body is not the statutory "employer" of the employees covered by that agreement, this exercise of the legislature's lawmaking authority is limited only by the terms of the federal and state constitutions, with the contract clause of the United States Constitution serving as the principal limitation.<sup>328</sup>

As discussed in this Article, numerous court decisions have considered the reach of the contract clause in this setting over the past thirty years. Most of these courts have properly applied the principles established by the Supreme Court in *United States Trust* to restrict the permissible scope of such arguably self-serving legislative modifications. A significant minority of decisions, however, have afforded substantial deference to such modifications even though they occur in a context in which the legislative body is hardly a disinterested observer.

While the legislative impairment of governmental contract rights is a necessary safety valve in some circumstances, an underlying theme of many of the minority decisions is that public sector collective bargaining agreements are not as worthy of protection as other types of contracts entered into by government entities. This Article takes issue with that theme as an undesirable vestige of the discredited notion that public employees owe a duty of "extra loyalty" to the state. Public sector collective bargaining agreements should not be treated as a second-class type of contract. A legislative body, accordingly, should be sustained in impairing its contract obligations to its employees on the same basis as other self-serving impairments; that is, only when such impairment is reasonable and necessary to serve an important government purpose.

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328. See *supra* notes 112-13 and accompanying text.