Fairfield UNIVERSITY

North East Journal of Legal Studies

Volume 32 *Fall 2014* Article 2

Fall 2014

Home Building and Loan Association v. Blaisdell Revisited

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HOME BUILDING and LOAN ASSOCIATION v. BLAISDELL REVISITED

by

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ABSTRACT

The Depression-era Supreme Court decision Home Building and Loan Association v. Blaisdell has been reviled as one of the worst in the history of the high court. This paper argues that it was one of the most prescient and practical of its decisions.

The 1934 Supreme Court case Home Building and Loan Association v. Blaisdell[1] made the list as one of The Dirty Dozen, a book authored by Robert A. Levy and William Melor in 2008.[2] The authors argue that Blaisdell, among others selected to their list of dishonor, ranks among the worst overreaches of government power sanctioned by the United States Supreme Court.

This article argues that the contrary is the case: that the decision was prescient in anticipating and signaling a change in the courts pro-business approach in 1937. It also demonstrated the court's deference to a state's decision to invoke its emergency powers to aid citizens caught in the economic disaster of the Great Depression.

The Dirty Dozen which added Blaisdell to the list of "bad decisions" by the high court, first appeared in 2008, just as the impact of the "Great Recession" was taking hold in the United States.[3]

This paper leaves it to the reader to judge if Blaisdell was a "bad decision" and also raises the question of why states did not intervene to protect their citizens in 2008-13 as they did in the 1930s.

The Background of the Case

In 1933, the state passed the Minnesota Mortgage Moratorium Act. The legislature was aware of the challenges facing farmers and home owners during the Depression.[4] Because many could not pay the mortgages that were due on their land and houses, the law allowed courts to prevent foreclosures even where the property owners had defaulted on their payments.

John and Rosella Blaisdell used the law to prevent their 14 room house and garage from being foreclosed upon even though they were paying a small amount to the lender each month.[5] The Home Building and Loan Association went to court to obtain its money but the state court ruled in favor of

the Blaisdells, that the law protected them from having to pay more than $40.00 per month which was the fair rental value of the property.[6]

The case turned on Article I section 10 of the Constitution which states:
"…No state shall pass any law impairing the obligation of contracts"…[7]

The clause, placed in the Constitution in 1787 at the urging of Rufus King, a delegate from Massachusetts, had its origin in the economic crisis in the fledging United States in the 1780s.[8]

Many Americans could not pay their debts and two points of view on the problem emerged. Creditors maintained that just debts should be paid since they had been legally incurred by the borrowers and through "hard work and frugality" the obligations should and could be met.[9]

On the other side were advocates of compassion for those who found themselves in financial distress. Some states passed laws that imposed delays on lawsuits brought by creditors to collect their debts.[10] Among the consequences of these laws was reluctance on the part of lenders to extend credit since there was uncertainty about their ability to eventually collect what was owed.

One of the most alarming events from the point of view of the propertied class was Shays Rebellion in 1786-1787. That uprising was led by small farmers who found themselves unable to pay their debts and taxes. Their plan was to prevent court sessions from being held to protect creditor rights.[11]

Ostensibly the reason for convening the Constitutional Convention in 1787 was to amend the governing document, allowing the Articles of Confederation, which contained no provision allowing the national government to intervene to

ameliorate the debt crisis.
The convention resolved to prohibit states from meddling in private contracts like the ones between creditors and debtors.[12]

Since the "contracts" clause contained very few words, the Supreme Court had to interpret what it meant, an opportunity that arose in some early cases most notably Fletcher v. Peck[13] and Trustees of Dartmouth College v. Woodward.[14]

Even though the clause did not distinguish between public and private agreements, Fletcher v. Peck dealt with the issue of public contracts. In that case, Chief Justice John Marshall used the contract clause to prevent Georgia from trying to avoid the consequences of land grants the state had made years earlier.

In the most prominent case involving the clause, Trustees of Dartmouth College v. Woodward, the Marshall court prevented the New Hampshire legislature from altering the 1769 charter that authorized the creation of the college.

From these early cases and others decided in the latter part of the 19th century, it was clear that the court established the parameters within which the Contract clause cases would be decided. The court determined that the clause applied to existing contracts not to future agreements. The court also believed that it was the intent of the framers of the Constitution to bar government interference with contracts that had already been made in accordance with laws that were in place at the time.[15]

It was also clear, and this became the salient point in Blaisdell, that the Contract clause is not superior to the police power of the states.[16] The latter power, which has never been ceded to the federal government, permits the state to exercise all powers that are necessary to protect the health, safety, and welfare of its people.[17] The principles of the Contract clause

and the state's police power collided in the Blaisdell case.

When the Blaisdells borrowed $3800.00 from the Home Building and Loan, they agreed to a mortgage on their home and land and that, if they defaulted, the lender could sell the property.[18] The Building and Loan put the property up for sale and then bought it for the amount of the mortgage which was in accordance with the original contract. Under the Minnesota law in effect when the Blaisdell's bought the property and when the Building and Loan eventually purchased it, the latter became the owner.[19]

Under the Minnesota Mortgage Moratorium Act however, the legislation declared because there was an economic emergency, the lender could not foreclose on the property even if the debtor did not pay his obligation.[20]

Upholding the law the Minnesota Supreme Court delayed the transfer of title to the Building and Loan for two years and ordered the Blaisdells to pay $40 each month and live in the house. If they paid the monthly fee, the Blaisdells could again pay the mortgage once the two years were up.[21]

To some, especially hard-passed debtors, this seemed like a fair bargain, but to those who were defenders of contract rights, it seemed as though the lender was being denied its rights to own and sell the property which put the Building and Loan in a vulnerable position subject to declining property values as the Depression continued.[22]

THE HUGHES MAJORITY v. THE SUTHERLAND DISSENT

The Supreme Court decision split 5-4. Voting with the majority were Justices Brandeis, Stone, Roberts and Cardozo.[23] The minority consisted of the so-called "Four Horsemen of the Apocalypse", Willis Van Devanter, Pierce Butler, James McReynolds and the author of the dissenting opinion, George

Sutherland.[24] These justices formed the conservative core of the court, striking down virtually all New Deal legislation that came before it.

The author of the majority opinion Chief Justice Charles Evans Hughes emphasized that the police power of the states is basic to the federal system, noting that the economic emergency did not justify its existence but did justify the use of the power.[25]

The Depression created the need for the use of the police power because of the dire conditions it had created for homeowners.

Hughes conceded that the Minnesota law was the kind that the contract clause was designed to prevent. In fact, early cases had voided similar laws.[26]

Hughes believed that the Constitution should be interpreted differently given the current conditions. An earlier precedent, Bronson v. Kinzie[27], appeared to be a case directly on point. Illinois had passed a law as a response to the Panic of 1837. The legislation allowed debtors to buy property sold at a foreclosure sale by paying the purchase price and 10% interest. The court struck down the law violative of the contract clause.[28]

Hughes seemed to believe that such precedents did not apply to the Blaisdell case. He preferred that the court apply cases which held that "the state…continues to possess authority to safeguard the vital interests of its people."[29] Significantly, he wrote:

> The economic interest of the state
> may justify the exercise of its continuing
> and dominant protective power
> notwithstanding interference with contracts.[30]

According to Hughes, the contract clause does not, therefore, prohibit all impairment of contractual obligations.

Hughes stated that the Court had a growing appreciation of "public needs and of the necessity of finding ground for a rational compromise between individual rights and public welfare."[31]

The originalist interpretation of the Constitution holds that "what the provision of the Constitution meant to the vision of that day it must mean to the vision of our time."[32]

Hughes believed that a judge could not fully know the meaning of a constitutional provision until he had considered the social and political background of the case.[33] A critic would argue that Hughes' approach places no constraints on the exercise of judicial power: The Constitution is whatever the justices of the Supreme Court at any given time say it is.

The basic premise of Justice Sutherland's dissent is that what the contract clause meant when "framed and adopted", it should mean for all time.[34]

> A provision of the Constitution….
> does not mean one thing at one
> time and an entirely different thing at
> another time."[35]

Sutherland was particularly disdainful of the majority's argument that "an essential attribute of sovereign power is to safeguard the vital interest of its people."[36] Sutherland questioned whether Blaisdell's financial problems affected the fundamental interest of the state.

Sutherland believed that there were certain activities within the police power of the state, like "banning the sale or manufacturing of intoxicating liquors" or preventing "private parties from creating harmful nuisances.[37] Debt relief did not fall into that category since the loan to the Blaisdell's was legal when it was made and similarl loans were legal even after the moratorium law went into effect.[38]

In Sutherland's view all the Minnesota legislature enabled the Blaisdells to avoid their obligations under a

contract they had entered and prevented the Building and Loan from enforcing an obligation that was as lawful after the statute was passed as it was before.[39]

The majority opinion believed that the relief provided by the statute was "reasonable and appropriate" since the Blaisdells had to eventually pay the mortgage. Only time for payment had been extended and during the extension period the Blaisdells still had to pay a monthly rent to the lender.[40]

Sutherland worried about the latter's plight more than that of the impoverished homeowner. Sutherland believed that the rental was scant compensation for the lender's inability to foreclose. Sutherland wondered about the impact on the lenders interests should the quality of the building deteriorate and the value of property fall below the purchase price.[41]

Hughes' majority opinion and Sutherland's dissent represent opposite poles of constitutional interpretation. Hughes believed that a provision of the Constitution has little meaning in the abstract, that it should be interpreted in the context of the entire Constitution and the "social situation confronting the court.[42]

Thus, there can be different results despite the similarity in the facts of the case depending on the point in time in which the case is decided.

Sutherland repudiated such a position stating that the Founding Fathers fixed the meaning of the Contract clause in all cases for all time. As Sutherland and the dissenters read the Contract clause, the mortgage moratorium law was unconstitutional.[43]

THE EFFECT OF BLAISDELL TODAY

While most commentators agree that Blaisdell rendered the Contract clause virtually moribund, there were two cases decided by the Court in the 1970s that belied that notion: United States Trust Co. v. New Jersey[44] and Allied Structural

Steel Co. V. Spannaus.[45]

In the United States Trust Co. case, the Court struck down a New Jersey law that impaired the rights of bondholders by repealing a covenant that barred the use of bond funds for mass transit. The court found that the impairment of the bond holders rights was not "necessary" since lesser measures could have been used to serve the state's goals.[46]

In the Allied Structural Steel case decided in 1978, the Supreme Court struck down a Minnesota law that impaired a private agreement. The law required that an employer who ended a pension plan or left the state had to fund pensions for workers with ten years of service to the company even if their rights were not vested under the original plan. The court found that this law significantly altered the obligations of employers under existing private pension fund contracts.[47]

Since its decision in the Allied case it appears that the Supreme Court has reverted to a Blaisdell like approach. In three cases,[48] the Court has made it clear that in cases involving the impairment of private contracts, it will defer to state's judgment of reasonableness and necessity.

It appears that the present Supreme Court defers to state legislatures' determinations of the need to abrogate a contract. The Court first determines if the state law involves a "substantial impairment of a contract.[49] If there is a substantial impairment, a state can argue that the law has "significant and legitimate public purpose" such as a alleviating a social or economic situation.[50] But as subsequent cases indicate, the problem need not necessarily be an emergency. For example in Energy Reserves Group, Inc. v. Kansas Power and Light Co., the Court upheld a law that capped price increases under a natural gas supply contract, which was an economic hardship not a national economic crisis.[51]

Finally the Court will not approve changes to the parties' contract if they are unreasonable and unrelated to the

purpose of the law.[52]

That the courts are unlikely to overturn state laws that abrogate contracts whose purpose is to remedy an economic hardship is evidenced by lower federal court action in connection with two natural disasters.[53] When Hurricane Andrew struck Florida in 1992, it was then the most expensive storm in United States history (later surpassed by Hurricane Katrina in 2005)[54] causing property damage amounting to $16-18 billion.

Because the insurance companies had written policies and charged premiums that were inadequate to cover the damage inflicted by Andrew, some insurance companies went bankrupt. After the storm, the companies that remained in business cancelled policies and did not renew others.[55]

In response, the state legislature passed and Governor Lawton Chiles signed legislation to bar the cancellation or non-renewal of homeowner's policies for six months.[56]

In Veta Fire Insurance Corp. v. State of Florida,[57] the Court of Appeals dismissed the Contract Clause argument by the insurance company holding "the statute's impact on existing insurance contracts cannot be said to be a constitutional impairment."[58]

In 2005 Hurricane Katrina struck several southern states including Louisiana, Mississippi and Alabama. Then Hurricane Rita hit southwestern Louisiana. Again the insurance companies were hit with extraordinary losses – in excess of $60 billion.[59] Under Louisiana law the companies had to allow policy holders twelve months to submit claims.

The Louisiana legislature passed a law signed by Governor Kathleen Blanco which extended the time period for the filing of claims to two years. The insurance companies sued claiming that Louisiana impaired their contractual obligations.[60] In State of Louisiana v. All Property and Casualty Insurance Carriers Authorized and Licensed to Do

Business in the State of Louisiana[61] the court held that measures taken by the legislature were both "appropriate and reasonable in order to protect the rights of the citizens of Louisiana and their general welfare".[62] The courts in both cases based their decisions on Blaisdell and its progeny.

Senator Ellen Anderson (DFL – St. Paul) and Representative Jim Davnie (DFL-Minneapolis) introduced the Minnesota Subprime Foreclosure Deferment Act of 2008 to stop foreclosures of sub-prime or negative amortization[63] loans for one year although homeowners would have had to make minimum monthly payments.[64] The one-year grace period would have allowed homeowners time to negotiate with their lenders while awaiting a federal program.

The legislators estimated that at least 15,000 homeowners of approximately 33,500 were expected to face foreclosure.[65]

Andersen and Davnie emphasized that their bill differed from the old Minnesota Mortgage Moratorium Act which was broader in scope. The 2008 version would have required lenders to cancel sheriffs foreclosure auctions for one year if the homeowner had a subprime or negative amortization loans made between Jan 1, 2001 and August 1, 2007.[66]

While homeowners would have had to continue making payments, they would have to pay than less 65% of the payments they were making when they defaulted or the minimum payment they made when they first got their loan. If the homeowner missed a payment, the foreclosure action would resume.[67]

The bill did not explain how property owners would later make up the money they did not pay during the grace period. Apparently that matter would have been left to negotiations between the banks and the homeowners.

Prentiss Cox, a law professor at the University of Minnesota, stated that the 1933 act was far more sweeping, but argued that because of the current crisis the state should

intervene as "a response to abusive and unfair subprime lending that went unchecked for a decade."[68]

The bill passed both Houses despite opposition mounted by the American Securitization Forum (ASF) and the Securities Industry and Financial Markets Association (SIFMA). Both groups argued that the law would result in increased costs for all borrowers and the possibility that the supply of money to the mortgage market would dry up.[69]

The argument became academic when Republican Governor Tim Pawlenty vetoed the bill. The Governor issued a written statement.

> No other state in the nation has enacted a bill like (this). There is a reason for that, it is not sound policy.[70]

The bill was never reintroduced but, given its modest provisions and the attitude of the Supreme Court in Blaisdell and in subsequent cases discussed here, it would likely have been upheld.

CONCLUSION

It is the duty of government to protect its citizens and the states have a weapon to do so: the police power. In the face of the greatest threat to the survival of the country: the Great Depression, Minnesota acted to protect homeowners from mass foreclosure.

> To claim as Sutherland did that the value of money being held constant, without the consent of the debtor, the mortgage moratorium statute of issue in Blaisdell represented an awkward, perhaps even clumsy, effort at the state level to undo the mischief brought on by federal action.

> The state statute can be justified not as an effort to correct market outcomes but as an effort to correct government misconduct – meddling with private contracts – that falls within the traditional confines of the police power.[71]

The issue in Blaisdell was far more complex than the 3800.00 owed by the family. The decision may have undermined the Contract Clause but enhanced the state's police power and gave the latter the right to protect its citizens to even the playing field between creditors and borrowers.[72]

The Supreme Court may well have to address even more ambitious efforts by the states and municipalities to assuage the adverse effects of the Great Recession. Many cities are embracing the concept of eminent domain as a device to seize homes that are underwater.

The Home Affordable Modification Program has not produced results many had hoped for because it relies on banks to deal with the crisis.[73]

Evidence shows that entities like the Bank of America "denied mortgage modifications to qualified homeowners, falsely claimed not to have received necessary paperwork, falsified electronic records, ignored properly completed applications, denied applications en masse because the paperwork was no longer current, and gave employees bonuses for pushing homeowners who qualified for modification because foreclosures were more profitable."[74]

During the housing bubble, banks bundled mortgages and sold securities backed by the loans. Since the banks do not own these securitized mortgages, they only service these mortgages for investors.[75] Therefore they have little incentive to expend the to negotiate a modification.

The bankers have threatened to sue and to cutback on

their lending so some communities have backed off. But other municipalities are forging ahead: to buy mortgages that are likely to end up in foreclosure and negotiate new ones that homeowners can afford.[76]

When the economic system fails can there be any doubt that the states can and should exercise the police power? As a result of the Blaisdell case, the states can take steps to protect its citizens and its communities.

In Blaisdell, Chief Justice Hughes recognized that the dire economic conditions created by the Depression justified the Courts decision. The Minnesota law was one of many passed during the period in the wake of mass violence and an avalanche of foreclosures and forced sales.[77] Lenders were able to take advantage of farmers at foreclosure sales, paying paltry sums for what ordinarily would have been valuable property.[78]

As one author has put it, "…if there was ever a time and place for debtor relief, Minnesota was the place."[79] The legislature passed the law for good reasons and a non-discriminatory purpose. In the 1780s the debtor protection law passed by the states that so concerned the farmers discriminated in favor of their own citizens against out of state creditors.[80]

The Minnesota law only dealt with in-state mortgage its purpose was not to harm creditor interests but to protect the state's economy. It was sound public policy. The law may have impaired mortgagor's rights but did not abrogate them.

One is left to wonder why more states did not attempt to take similar action during the Great Recession of 2008-2013. Was it the timidity of the politicians or the power of the banking interests that caused so many foreclosures and dislocations?

ENDNOTES

[1] 290 U.S. 398 (1934)

[2] The Dirty Dozen: How Twelve Supreme Court Cases Radically Expanded Government and Eroded Freedom, Cato Institute (hereinafter The Dirty Dozen)

[3] Id.

[4] Id. at 54.

[5] Amity Shlaes, "Judging the Judges: The Dirty Dozen" by Robert A. Levy and William Mellor, Wall St. J. May 1, 2008 at A15.

[6] Id.

[7] U.S. Const., Art I, § 10 cl.1.

[8] supra, note 2 at 55.

[9] Id. at 54.

[10] Id. at 54-55.

[11] Id. at 55. See Frederick Lewis Allen. Since Yesterday: The 1930s in America Sept. 3, 1929 – Sept. 3, 1939. Harper-Row 1939 at 86-88 for a description of farmer's reaction to foreclosures in 1930s.

[12] Id.

[13] 10 U.S. (6 Cranch) 87 (1810).

[14] 17 U.S. (4 Wheat) 518 (1819)>

[15] Ogden v. Sanders 25 U.S. 12 Wheat 213 (1827).

[16] Atlantic Coast Line Railroad Co. v. City of Goldsboro, 232 U.S. 548, 558 (1914).

[17] Police power consists of residual prerogatives of sovereignty which the states had not surrendered to the federal government. Lawrence H. Tribe American Constitutional Law § 6-3 at 405 (2ed 1988).

[18] The Dirty Dozen at 57.

[19] Id.

[20] Id.

[21] Id. at 58.

[22] Id.

[23] Charles A. Bieneman "Legal Interpretation and a Constitutional Case: Home Building and Loan Association v. Blainsdell" 90 Mich L. Rev, 2534-2564 at 2536 n. 14 (hereinafter Legal Interpretation and a Constitutional Case).

[24] Id.

[25] Id. at 2536.

[26] Id. at 2537.

[27] 42 U.S. (I How) 311 (1843).

[28] "Legal Interpretation and a Constitutional Case, supra note 23 at 2537 n. 25.

[29] 290 U.S. at 434.

[30] 290 U.S. at 437.

[31] 290 U.S. at 442.

[32] 190 U.S. at 442.

[33] Legal Interpretation and a Constitutional Case at 2539.

[34] 290 U.S. at 449.

[35] 290 U.S. at 448.

[36] The Dirty Dozen, supra note 2 at 60.

[37] Id. at 61.

[38] Id.

[39] Id.

[40] Id.

[41] 290 U.S. at 481.

[42] 290 at U.S. 434.

[43] 290 U.S. at 449.

[44] 431 U.S. 1 (1977).

[45] 438 U.S. 234 (1978).

[46] Henry N. Butler and Larry E. Ribstein, "Symposium: Regulating Corporate Takeovers: State Anti-Takeovers Statues and the Contract Clause," 57 Cin. in. L.Rev 611 (1988) at 628 (hereinafter "Regulating Corporate Takeovers").

[47] Id. at 629.

[48] Energy Reserve Group v. Kansas Power and Light Co. 459 U.S. 400 (1983) Exxon Corp v. Eagerton 462 U.S. 179 (1983) and Keystone Bituminous Coal Association v. Debenedicis 107 S.Ct. 1232 (1987).

[49] The Dirty Dozen at 63.

[50] Id.

[51] Id.

[52] Id.

[53] Id. at 64-65.

[54] Id. at 64.

[55] Id. at 64.

[56] Id.

[57] 141 F.3d. 1427 (11th Cir. 1998).

[58] The Dirty Dozen at 65.

[59] Id.

[60] Id.

[61] 937 So.2d 313, (La 2006).

[62] 937 So.2d. 327.

[63] Negative amortization mortgages have payments even less than the interest charged on the loan which increases the loan balance over time. Jennifer Bjorhus, "MN Bill to Stop Subprime Foreclosure For One Year," Twin Cities.com. PioneerPress.com, Mar 7, 2008, rense.com.

[64] Id.

[65] Id.

[66] Id.

[67] Id.

[68] Id.

[69] "ASF and SIFMA Oppose Minnesota Subprime Foreclosure Deferment Act, www.sifma.org, Mar 17, 2008.

[70] Tom Streissguth, "What Is the Minnesota Mortgage Deferment Act?", www.ehow.com/info_8243894.

[71] Richard A. Epstein, "Toward a Revitalization of the Contract Clause," U. of Chicago L.Rev 51, 703-751 (Summer 1984) at 737.

[72] Id.

[73] Brad Miller, "Fighting Foreclosures With Eminent Domain," Wall St. J. July 3, 2013 at A13.

[74] Id.

[75] Id.

[76] "California City Moves to Expand Eminent Domain Proposal", The Boston Globe, Sept. 12, 2013 at B9. See also "A City Works to Save Homes By Invoking Eminent Domain", N.Y. Times, July 30, 2013 at A1-B25.

[77] "Legal Interpretation and a Constitutional Case", supra note 23 at 2561.

[78] Id.

[79] Id.

[80] Id.