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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1687

UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee for The Port Authority of New York and New Jersey Consolidated Bonds, Fortieth and Forty-First Series, on its own behalf and on behalf of all holders of Consolidated Bonds of The Port Authority of New York and New Jersey and all others similarly situated,

Appellant,

v.

THE STATE OF NEW JERSEY, BRENDAN T. BYRNE, Governor of the State of New Jersey, and WILLIAM F. HYLAND, Attorney General of the State of New Jersey,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

BRIEF FOR APPELLEES

COUNTER-STATEMENT OF THE CASE

Introductory Statement

This is an appeal from a judgment of the Supreme Court of New Jersey, unanimously affirming a judgment of the Superior Court of New Jersey (Hon. George B. Gelman, J.S.C.), upholding the constitutionality of Chapter 25 of

the Laws of New Jersey, 1974.[1] The challenged 1974 statute, together with concurrent and identical New York legislation, Chapter 993 of the Laws of New York, 1974, repealed 1962 bi-State legislation purporting to limit by covenant the application of the revenues and reserves of the Port Authority of New York and New Jersey for passenger railroad purposes.

The trial court found that, "the claim that bondholder security has been materially impaired or destroyed by the repeal is simply not supported by the record." A 127.[2] The trial court further held that repeal constituted a reasonable exercise of the State's police power. Judgment was entered accordingly, dismissing appellant's complaint and declaring Chapter 25 valid and constitutional. On direct appeal, the Supreme Court of New Jersey unanimously affirmed, "substantially for the reasons set forth in the opinion of Judge Gelman." A 135.

Appellees respectfully submit that the judgments below were correct and should be affirmed.

A. The Early Years: A Port Authority That Was Not Self-Sustaining, the Arrangements That Enabled It to Carry Deficits and the Failure of Legislative Efforts to Have the Authority Assume Responsibility for Passenger Railroads

The Port Authority Compact was enacted by New Jersey and New York and consented to by Congress in 1921. Ch. 151, Laws of N.J., 1921, N.J.S. A. 32:1-1 *et seq.*; Ch. 154,

1. The statute appears at pages 5-6 of Appendix B to the Jurisdictional Statement.

2. "A" refers to the Appendix. "A.B." refers to the brief for appellant. "Stip." refers to the Stipulation among counsel dated December 20, 1974, the entire text of which is contained in Volume IV of the Joint Appendix (cited as "Ja") submitted to the Supreme Court of New Jersey.

Laws of N.Y, 1921, McKinney's Unconsol. Laws §6401 *et seq.*; Pub. Res. 17, 67th Cong., 1st Sess., 42 Stat. 174 (1921). Declaring that "a better coordination of the terminal, transportation and other facilities in, about and through the port of New York, will result in great economies, benefiting the Nation, as well as the States of New York and New Jersey," the Compact created the Port of New York Authority to pursue those elusive goals.[3]

The Compact granted the Port Authority enumerated powers "and such other and additional powers as shall be conferred upon it by the legislature of either State concurred in by the legislature of the other, or by Act or Acts of Congress." Compact Art. III; see also Art. VII. Among the powers enumerated is "full power and authority to purchase, construct, lease and/or operate any terminal or transportation facility within the [Port] district." Compact Art. VI. "Transportation facility" is in turn defined to include "railroads . . . for use for the transportation or carriage of persons or property." Compact Art. XXII.

In 1922, the States, again with the consent of Congress, adopted a Comprehensive Plan mainly concerned with railroad freight operations and facilities. A 69. But the Comprehensive Plan was never implemented, in part because of the Port Authority's refusal in 1922 to help solve the problems of railroad passenger traffic. See E. W. BARD, THE PORT OF NEW YORK AUTHORITY 65-66, 128-130 (1942) (hereinafter cited as BARD).

New Jersey quickly recognized that the Comprehensive Plan was not sufficiently comprehensive: it enacted a law in 1922 finding that the Comprehensive Plan "does not include the problem of passenger traffic in the territory covered by [the] port development plan" even though the

3. The name of the Authority was changed to the Port Authority of New York and New Jersey on July 1, 1972. N.J.S.A. 32:1-4.

"problem of passenger traffic should be considered in co-operation with the port development commission." A 569.[4]

The Port Authority also recognized that freight and passenger service were not two problems but inseparable parts of a single problem. Its 1924 Annual Report observed:

> "There is barely room during the rush hours for the trains carrying freight because of the commuter service, while passengers and freight must both necessarily move during these hours." A 156.

The point was repeated in the Port Authority's 1928 Annual Report:

> "The Commissioners of the Port Authority have found in their studies that no adequate or effective interstate transportation development can take place without taking full account of transportation of passengers as well as of freight throughout the Port District." A 151, 575.

The Legislatures of both States agreed. In 1927, the New Jersey Legislature, stating that it was acting "under and pursuant to the provisions of the [Port Authority] compact," directed the Port Authority "to make such plans for the development of said district supplementary to or amendatory of the comprehensive plan heretofore adopted by the Legislatures of the two States . . . as will provide adequate interstate and suburban transportation facilities for passengers. . . ." A 57.[5] This legislation, which became

4. The legislation established a study commission that worked with the Port Authority in establishing a new agency, of which the Authority was a member, to coordinate solutions to the problems of commuter transportation. A 576.

5. In light of this early history, appellant obviously errs at the very outset of its discussion of "Port Authority Involvement in Mass Transit," A.B. 8, when it says: "As early as 1922, the legislatures recognized that the Port Authority was not the appropriate agency to develop a solution to the problems of railroad passenger traffic." *Id.*

Chapter 277 of the Laws of New Jersey, 1927, was signed by Governor Moore and approved the following year by the New York Legislature, but was vetoed by Governor Alfred E. Smith. A 572-574.[6] As the trial court found, Governor Smith's veto ended the Port Authority's active involvement in any solution of commuter transit problems for the next 30 years. A 80.

The Port Authority took a new tack and began its construction program by building four bridges for motor vehicles. A 71. These bridges, which still account for much of the Port Authority's financial strength, see A 737, were made possible by advances from the States to pay 25 percent of the costs of construction. The advances took the form of loans subordinated to the bonds the Authority sold to the public. A 71. A separate series of bonds was issued for each bridge and the bondholders' security was limited to the revenue from that bridge. A 71. In their early years, however, the bridges did not meet revenue expectations and the Authority was not only not self-supporting, but faced default on its bonds. A 70 n. 8, 72, 820.

The Legislatures' response to the Port Authority's predicament was two-fold. First, they transferred the control, operation and revenues of the highly successful Holland Tunnel to the Authority: its annual surpluses after debt service were large enough to cover the bridge deficits. BARD at 238; A 70 n. 8. Second, the States enacted statutes creating the General Reserve Fund, in which surplus revenues from all Authority facilities are pooled to create a bondholders reserve fund in an amount equal to 10 percent

6. Appellant says, A.B. 8, that Governor Smith vetoed the bi-State legislation "on the ground that the Port Authority was never intended to become involved in rail mass transit." The veto message, A 572-574, contains no such statement and bases the veto on Governor Smith's unwillingness to divert the Authority from the solution of the freight distribution problem. The Port Authority Commissioners responded that the feared diversion of efforts would not take place, A 151 n. 9, demonstrating that they too understood this to be the basis of the veto.

of the par value of the Authority's outstanding bonds. A 72. The General Reserve Fund, which contained $173,487,000 when the 1962 covenant was repealed, A 817, is irrevocably pledged as security for the Port Authority's bonds. A 72, 791-795.[7]

The General Solicitor of the Port Authority, Daniel B. Goldberg, characterized the General Reserve Fund as "the absolute foundation of the Port Authority's whole financial structure." A 821. In addition to offering an attractive inducement and security to investors, the General Reserve Fund, by eliminating the prior separation between facilities, permitted the Authority "to meet the requirements of any financially weak facility which had not yet reached its stride or which for any other reason could not at a particular point of time carry its own load."

Appellant claims, A.B. 5-6, that "The superior court outlined the basic financing principles which have guided the Port Authority for over fifty years" and included among these principles the requirement that "the specific projects undertaken by the Authority should be self-supporting, *i.e.*, the revenues of each should be sufficient to cover its operating expenses and debt service requirements. . . ."

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7. The creation of the General Reserve Fund made the Port Authority's fiscal strength possible. It also made it possible for the Authority to insulate surplus revenues from public control.

The General Reserve Fund statutes, enacted in 1931, provided that any surplus revenues not needed to maintain the Fund in its prescribed statutory amount, 10 percent of the par value of the Authority's outstanding bonds, "shall be used for such purposes as may hereafter be directed by" the States. N.J.S.A. 32:1-142. In 1935, however, the Authority adopted a bond resolution providing that only 50 percent of its surplus revenues could be used for "any purpose permitted by law." BARD at 256; A 827.

The General Reserve Fund reached the prescribed level in 1946. A 826. In 1947, the Authority announced that as a matter of policy it would attempt to retain in all of its reserve funds an amount equal to at least the next two years' debt service on its bonds. A 829-831.

Finally, in 1952 the Authority adopted its Consolidated Bond Resolution and Series Resolutions. These resolutions prohibited the Authority from using any of its reserve funds unless such use was "to or for the benefit of" bondholders.

Appellant is wrong. In 1924, the Port Authority's Annual Report said that "it should not be expected to be self-supporting." A 159. By 1931, it faced default on its bonds because its individual facilities were not self-supporting. After the 1931 pooling legislation, there was no requirement that individual facilities be self-supporting so long as the Authority as a whole was in the black. Though the self-supporting facility concept may have "initially emerged," as the trial court actually said, A.B. 6, A 71, the concept had no practical significance because it was not attained prior to 1931 and was unnecessary after 1931. As Dr. Bard wrote in 1942:

> "The 1931 legislation changed the formula from simply self-sustaining to self-sustaining as a group. The device of grouping facilities and pooling revenues shifted the basis of credit from a judgment as to the capacity of a new project to be self-sustaining to a judgment as to the future of existing revenues affected as they might be by the new project." BARD at 325.

See also *id.* at 265 (the General Reserve Fund "had the effect of eliminating the individual facility as a basis for credit, and shifted that basis to the group as a whole").

Appellant's claim that the Port Authority has always been guided by the principle that each facility must be self-supporting is also refuted by the Consolidated Bond Resolution. The trial court found that with the adoption of that resolution in 1952, the self-supporting facility concept "ceased to have the significance previously attached to it." A 74. He further found: "While some facilities may not yield sufficient revenues to pay operating expenses and/or debt service requirements, what is of paramount concern to bondholders under the CBR is whether the total revenues of the Authority are sufficient to satisfy all of its obligations to bondholders." *Id.* Indeed, the independent

auditors retained by the Farley Committee in 1960 specifically reported that "few of [the Authority's] facilities would have financially feasible without the ability to pool revenues of all facilities." A650.

B. The Port Authority Seeks Immunity From the "Disease" of Commuter Railroads[8]

1. *The Metropolitan Rapid Transit Commission study*

The years following the creation of the General Reserve Fund were filled with studies and reports decrying the deteriorating condition of rail mass transit. See A 80-81; Stip., pp. 83-97. In 1954, the States established the Metropolitan Rapid Transit Commission to study the problem. Stip., p. 99. In 1955, the MRTC issued an interim report observing that, since 1930, billions of public dollars had been spent on the development of tax-exempt or subsidized vehicular highways and bridges, but no public funds had been spent on rail mass transit between New York and New Jersey. The report concluded that the proposal of the Port Authority and the Triborough Bridge and Tunnel Authority to spend $577,000,000 on new and expanded vehicular bridges "raises the fundamental question of public policy whether any further crossings of the Hudson River should be constructed until it is determined whether future crossings should be designed to encourage rail or vehicular traffic." Stip., pp. 100-101.

By this time, the Port Authority had come to a marked preference for rubber over rail, see, *e.g.,* Stip., Exhibit VII at Volume VI of the Joint Appendix below, pp. 121A-138A. Accordingly, when the MRTC ran out of funds to continue its work, the Authority agreed to finance a comprehensive study of the interstate rail problems on the basis of a

8. The characterization is that of Daniel B. Goldberg, General Solicitor of the Port Authority. A 839.

"Memorandum of Understanding" between the Authority and the MRTC stating that the Authority was able to undertake facilities "only if competent estimates indicate that in the long run they will be self-liquidating in and of themselves" and that the maintenance and improvement of metropolitan rail transit systems "could not be economically self-supporting." Stip., p. 102. See also A 161-162. In other words, using the false premise that the Authority could only undertake projects that were in and of themselves self-supporting, the Authority agreed to finance the MRTC study of the problem on condition that it would not be part of the solution. In 1958, the MRTC issued its report commenting at length upon the "constant and relentless deterioration of suburban rail service," which it characterized as a "looming crisis." A 82. True to the Memorandum of Understanding, the MRTC said that improved rail mass transit "financing would not be available from any of the existing public authorities." *Id.*

Nevertheless, during the 1958 session of the New Jersey Legislature, a bill was introduced (Assembly Bill No. 16) that would have required the Port Authority to take over, improve and operate interstate rail mass transit between New Jersey and New York. A 82-83. The Authority responded with a new bond provision to make sure that it would not be "open to this kind of a financial raid," A 838, and it marshalled a powerful political offensive. Each is discussed in detail below.

2. *The new bond provision—Section 7 certification*

When the New Jersey Assembly began considering Assembly Bill No. 16, the Port Authority began including a new safeguard in its contracts with bondholders. Since 1958, Section 7 of the resolution that authorizes each series of bonds (hereinafter "the Series Resolutions") has prohibited the issuance of any bonds secured by the General

Reserve Fund for any facility not previously financed by bonds secured by the General Reserve Fund (such as a rail mass transit facility), unless the Port Authority first certifies that the issuance of those bonds would not materially impair the sound credit standing of the Authority, the investment status of Consolidated Bonds or the ability of the Authority to fulfill its commitments, including its undertakings to the holders of Consolidated Bonds. A 78, 811-812. In 1961, Mr. Goldberg explained that the Section 7 certification was adopted to make it absolutely clear that "deficit-ridden railroads" could not be brought into the General Reserve Fund family. A 839-80.[9]

3. *The New York commuter car episode*

Since the Port Authority's resistance to efforts to involve it in commuter car financing appears to have served as a model for the Hudson and Manhattan struggle, and since appellant claims at A.B. 14, 73 that, in preference to repeal, the States should adopt this method of financing rail mass transit improvements, it deserves far closer examination than is provided in the anticipatory footnote 8 at A.B. 10.

In February 1959, Robert W. Purcell, a transportation adviser to Governor Rockefeller, raised the possibility of the Port Authority's issuing bonds to finance passenger equipment purchases for the Long Island and New York Central Roalroads. The idea called for the Authority to be reimbursed in full, including interest costs, via rental payments to be made by the railroads. A 313-314. As originally proposed by Mr. Purcell, the States would not have guaranteed payment of the bonds.

R. M. Schmidt, a vice president of Blyth & Co. and head of its municipal finance department, A 307, advised Mr. Purcell that his idea seemed "ingenious and something worthwhile exploring." A 313.

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9. Each Series Resolution declares that it "shall constitute a contract with" bondholders. Stip., Ex. II, Section 2, at 72, in Volume V of the Joint Appendix below.

Two days later, Port Authority Executive Director Austin Tobin began to organize "bondholder concern" in opposition to the plan. Mr. Schmidt described the Port Authority pressures in detail:

> "the Authority on Friday, February 27th, called our office and asked us to meet with them at the First National City Bank on Monday, March 1st. George LeVind and Fred Miller attended that meeting. Also, the managers of the syndicates that usually bid for their bonds at public sale, namely Harriman Ripley & Co. (our joint account partners) and Halsey, Stuart, Glore Forgan and Drexel who are joint managers of the competing syndicate. They presented a strong story disapproving the plan and the adverse effect on their credit and market for their bonds, also submitted a suggested letter for the managers to sign. LeVind, Miller and Hawes discussed their request and also talked with me at home. We all agreed not to sign the letter or send any letter.
>
> "Following this, Gene Mintkeski (Port of N. Y. Auth.) called me at home and talked with me for about 15 minutes. He apparently was very much disturbed over the fact that we would not sign such a letter and that I had told Mr. Purcell I thought his idea was ingenious, worth studying and exploring. I stated that at no time did I give approval or disapproval to Mr. Purcell's idea. We felt very strongly that we should have in greater detail Mr. Purcell's plan and at least give him an equal chance to present an answer to the position that the Port of New York Authority is taking.
>
> "On Tuesday, March 3rd, at 1 P.M. Joe Ripley of Harriman Ripley telephoned and asked me to go over there for lunch to discuss this Port of New York Authority problem. He had with him Elwood Smith, Stu Silloway and Berry. He stated the luncheon was prompted by Mr. Cullman coming to see him and considerably upset because he had heard that I had given approval to Mr. Purcell's plan and wanted to know whether or not I had.

> "The foregoing memorandum answers that. I told him specifically I had not given my approval but in response to a call to us I gave Mr. Purcell the courteous consideration that he was entitled to and reviewed the whole story as written above. They had no criticism of my action. In fact, Joe Ripley thought he would have acted in the same manner I had if he had had a call from a representative of Governor Rockefeller.
>
> "I reported all this to Messrs. Hawes and Miller and also in compliance with a request from Mr. Cullman (which was arranged by Mr. Ripley) I then called Austin Tobin. The conversation was very unpleasant. He, in fact, requested—if not demanded—that we write a letter disapproving the Purcell plan which I told him we would not do and I took exception that they quoted me out of context in their letter of March 2, which he denied. The conversation was very acrimonious and I would say that Mr. Tobin was rude, officious and impertinent and I ended by telling him so.
>
> R. M. Schmidt"

A 313-315.

Mr. Cullman was Honorary Chairman and a Commissioner of the Port Authority at the time and he seconded Mr. Tobin's efforts with vigor. See, for example, A 316, a March 5, 1959 message from Mr. Cullman to Mr. Ripley:

> "Governor Rockefeller was informed that issuing equipment trust to the railroads would not hurt Port Authority credit, and that all the investment bankers were unanimous that that was so. And, therefore, Mr. Cullman feels that it is very important that Mr. Ripley send him the letter he requested."

Mr. Ripley sent the requested letter and Mr. Tobin reported to Mr. Ripley by letter dated March 17, 1959:

> "the proposal for Port Authority participation on the basis of what was called 'equipment trust financing' or, for that matter, suggestions for any financial assistance by the Port Authority in the field of commuter rapid transit were dropped. We were then able to come to this combination of state advances and bonds guaranteed by the state, with the Port Authority simply carrying out the administrative and managerial work of the state's participation." A 333-334.

Testifying about the matter in 1960, Mr. Tobin acknowledged that the Port Authority had "appealed" to the investment bankers to oppose the Purcell plan. A 303. He added: "So that such meetings as you describe were held, *and would be held again in similar circumstances.*" A 304; emphasis added.

Mr. Tobin did call such a meeting in July 1960, to "appeal to the investment bankers" for assistance against a House Judiciary Subcommittee investigation of the Port Authority. He characterized the Subcommittee's investigation of his agency "a grievious threat to State and municipal financing." A 340-342. And once again the concern of the investment community was expressed. A 343-344.

4. *Opposing New Jersey legislation in 1958*

Mr. Tobin had in fact turned out the troops even before the Purcell episode. As mentioned above, at the 1958 session of the New Jersey Legislature, Assembly Bill No. 16 had been introduced: it would have required the Port Authority to assume responsibility for commuter railroads between New Jersey and New York. A 82-83. The Port Authority expressed a view strongly opposing the legislation and, as the trial court found, "To reinforce this view the Authority solicited and included in its statement similar expressions of opinion from members of the invest-

ment banking community." A 83. Having solicited opposing statements, the Port Authority duly reported that its opposition "is supported by views expressed by other responsible persons in the investment and banking field, who as a practical matter, are the controlling influence upon the receptivity of bondholders to Port Authority investment." A 589.

The "other responsible persons in the investment and banking field" were the same small group to whom Mr. Tobin appealed for help against Mr. Purcell. In fact, the Port Authority statement mentions only two by name—E. B. Rockwell of Halsey, Stuart and Company and Reginald M. Schmidt of Blyth and Company. A 589-590. Mr. Schmidt was obviously concerned about the specific proposal contained in Assembly Bill No. 16, A 590, but was not categorically opposed to Port Authority involvment in mass transit. Indeed, he would later charge Mr. Tobin with quoting him out of context. A 315, quoted at page 12, *supra.* Mr. Rockwell, on the other hand, parroted the Port Authority's categorical position. The Authority opposed Assembly No. 16 "or *any other legislation* which would attempt to involve the Port Authority *in any way* in responsibility for rapid transit." A 586; emphasis added. Mr. Rockwell of Halsey, Stuart did likewise:

> "In our opinion *any assumption of responsibility* on your part for rail rapid transit in the New York area would, *on almost any conceivable terms,* be harmful to the present investment standing of the Port bonds and would adversely affect the ability of the Port Authority to finance in the future on terms as favorable as hitherto. In our opinion, it is most essential for the preservation of The Port of New York Authority to be *completely free of any responsibility whatsoever for rail rapid transit in this area.*" A 589-590; emphasis added.

C. Legislative History of the 1962 Covenant

Until 1962, the leadership of the Port Authority had resolutely, and successfully, opposed meaningful Port Authority participation in the carriage of persons by rail. General Solicitor Goldberg called it "a disease," A 839, and the Authority's Executive Director, Austin Tobin, was a vigorous practitioner of preventive medicine. On any proposal having to do with mass transit, Mr. Tobin would go to his underwriters and ask them to express concern for the Port Authority's credit, whether they felt it or not. He would then report to the Legislature, or the Governor, that they must bow to these "responsible investment banking leaders. For all practical purposes they are the controlling influences of our credit." A 592.

And so it was with the covenant. It was unquestionably the Port Authority's idea. See, *e.g.,* A 95-96, 183, 841. These unambiguous record references plainly show that there is no basis for appellant's repeated and wholly unsupported characterization, A.B. 27-28, 77, of the covenant as something "for which they [bondholders] had bargained." And the Authority imposed it on the Farley Committee on the usual ground—the Authority could not sell bonds without it. See, for example, the extraordinary claim of Authority Commissioner Kellogg:

> "Applied to the H&M proposal, I would like to make it clear that the question of whether or not we can borrow the $83,500,000 which is required, is not simply a question of whether or not we would have to pay a higher rate of interest on these funds. We can only submit to you the unanimous view of the Commissioners of the Port Authority that there is no possibility whatsoever of borrowing the money at all without a statutory assurance to investors that any future Port Authority responsibilites in the field of commuter rail transport over and above the present and existing interstate Hudson and Manhat-

> tan railroad system will not involve a pledge of the Port Authority's General Reserve Fund." A 87, 632-633.

Even appellant's chief witness in this proceeding never claimed that the Authority could not sell bonds without the covenant. Mr. Thompson opined only that, "All other things remaining equal and the authorization for the PATH takeover and the World Trade Center without the covenant would have resulted in my opinion in a less favorable market for the Port Authority bonds and a higher interest for the Port Authority bonds." A 859. "All other things remaining equal" would, of course, include Mr. Tobin's saying that without the covenant the Port Authority's credit would be ruined, and this element of the hypothesis was expressly called to Mr. Thompson's attention. A 858. Similarly, appellant's sole investor witness testified, "I can't say for certain we would not have purchased" Port Authority bonds without the covenant. A 1105.

It is also worth noting that the Commissioners who were unanimously of the view "that there is no possibility whatsoever of borrowing the money at all" without the covenant were the same Commissioners who, two years earlier, had been unanimously opposed to any legislation "which would attempt to involve the Port Authority in any way in responsibility for rapid transit." A 586. Yet, in the intervening two years, the lack of any foundation for the Commissioners' earlier claims had become apparent to all. A 1959 Joint Assembly Committee report on Assembly Bill No. 16 had concluded that the Authority should assume some rail mass transit deficits. A 83-84, 593-597.[10] See

10. Appellant erroneously characterizes this report as concluding that the Authority "should only become involved in self-supporting facilities. (A 593-597)." A.B. 10 n. 7. In fact, the legislative report understood and referred to the pooling concept and said that the Authority "no doubt could undertake an activity which would involve a deficit—even a permanent one." A 594.

also A 162. And in April 1960, the New Jersey Highway Department issued a report that concluded, A 608:

> "The Port of New York Authority should not, in our opinion, be handed New Jersey's rail problem, nor should it become responsible for the New York subway system or for rail transportation for Westchester or Long Island. We are certain however, that the interstate aspects of the rail movement of persons and goods such as purchase and lease of new Hudson and Manhattan commuter cars and the purchase of the existing interstate railroad ferry boats, do come within their obligations. The foregoing fully recognizes the importance of maintaining the Port of New York Authority's commitments and credit requirements."

The Port Authority beat a strategic retreat: it would take over the crumbling but vital Hudson & Manhattan Railroad on condition that the Legislatures give it the 1962 covenant.[11] Unable to claim any longer that any involvement whatsoever of the Port Authority in rail mass transit would destroy its credit, unable to claim even that acquisition of the Hudson and Manhattan would impair bondholder security, the Port Authority claimed that *any future involvement whatsoever* would make its bonds unsalable. And the Legislatures, anxious for progress on the Hudson and Manhattan, accepted Mr. Tobin's terms, see A 612, 642, after Senator Farley expressed his opinion that "one Legislature cannot bind a subsequent Legislature involving policy." A 87-90, 635-639.

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11. The 1962 legislation contains detailed findings about the importance of rail mass transit, the plight of the Hudson & Manhattan Railroad and the need for its acquisition by the Port Authority, but none about the need for the 1962 covenant. See N.J.S.A. 32:1-35.50. Yet appellant complains about the absence of specific legislative findings supporting repeal of the covenant. See A.B. 26, 56.

D. The 1962 Covenant

The 1962 covenant was a part of the bi-State legislation authorizing the Port Authority to acquire, construct and operate the Hudson & Manhattan Railroad and the World Trade Center. A 90-91, 672-673. In revelant part, the statute says, N.J.S.A. 32:1-35.55, A 92:

> "The 2 States covenant and agree with each other and with the holders of any affected bonds, as hereinafter defined, that so long as any of such bonds remain outstanding and unpaid and the holders thereof shall not have given their consent as provided in their contract with the port authority, . . . (b) neither the States nor the port authority nor any subsidiary corporation incorporated for any of the purposes of this act will apply any of the rentals, tolls, fares, fees, charges, revenues or reserves, which have been or shall be pledged in whole or in part as security for such bonds, for any railroad purposes whatsoever other than permitted purposes hereinafter set forth."

"Permitted purposes" were defined by the statute to include: (i) the Hudson Tubes as it existed on the effective date of the legislation, (ii) railroad freight facilities, (iii) railroad tracks and related facilities on vehicular bridges owned by the Port Authority, and (iv) a passenger railroad facility, if the Port Authority first certified either that the facility is "self-supporting" or, if not, that at the end of the preceding calendar year the General Reserve Fund contained the prescribed statutory amount and that all of the Authority's passenger railroads, including the Hudson & Manhattan, will not produce deficits in excess of "permitted deficits."

With respect to permitted purpose (iv), a passenger railroad facility would be deemed to be "self-supporting" if the

"amount estimated by the port authority for the ensuing 10 years to be the average annual net income (computed without deduction of debt service) derived from or incidental to such facility equals or exceeds the amount estimated by the port authority for such 10 years to be the average annual debt service upon bonds for purposes in connection with such proposed facility."

Though the covenant is not explicit on the point, both States, the Port Authority and its bond counsel have all agreed that State subsidies may be included in the computation of "average annual net income . . . derived from or incidental to such facility." Stip., p. 239 and Ex. VIII in Volume VI of the Joint Appendix below. Thus, a passenger railroad would be self-supporting if, "for the ensuing 10 years," the Port Authority's estimate of net operating revenues and State support equalled its estimate of debt service "upon bonds for purposes in connection with such proposed facility."

"Permitted deficits," the alternative method to satisfying permitted purpose (iv) for a new passenger railroad, were defined to mean that the annual estimated deficit (after including estimated debt service) of both the Hudson Tubes and any additional non-"self-supporting" passenger railroad facility could not exceed one-tenth of the General Reserve Fund (or one percent of the Authority's total bonded debt). Here too State subsidies are at least theoretically possible, though on more difficult terms than under the "self-supporting" rubric. The parties stipulated, A 692, and the trial court found, A 94n. 26, that the annual deficits of the Hudson Tubes exceed the "permitted deficits" and the covenant therefore prohibits the Authority from issuing bonds secured by its reserve funds for any new deficit passenger rail facility.

E. The Unimportance of the 1962 Covenant to Bondholder Security

In reality, and as Dr. Bard found back in 1942 and the Assembly Committees reported in 1959, bondholders needed assurance that the Port Authority would not be so burdened with deficits that its profitable facilities might have difficulty carrying them.[12] But the provisions of the Consolidated Bond Resolution and the Series Resolutions fully protected them against that possibility, as will appear presently. The covenant was necessary to protect not the bondholders' security but Mr. Tobin's conception of the Port Authority as a master builder of bridges, tunnels, airports and, ultimately, the $1 billion World Trade Center. Years later, in explaining why bondholders had nothing to fear if the covenant were eliminated, Moody's would make the point: "demands for mass transportation would probably obstruct further Authority expansion into other fields. Bondholder protection would remain adequate. . . ." A 750-751.

Similarly, in a report issued just two weeks after the trial court's decision sustaining repeal, Barr Brothers, from whom appellant selected one of its four witnesses, stated unequivocally: "Whether or not the Port Authority ever gets involved in Mass Transit, we feel it continues to be one of the finest revenue credits in the country, amply protected by the basic bond resolution. . . ." A 423. In sum, the trial court correctly concluded that:

> "The claim that bondholder security has been materially impaired or destroyed by the repeal is simply not supported by the record." A 27.

Nothing in appellant's brief detracts in the slightest from the validity of this fundamental conclusion that, in and of itself, requires affirmance of the judgment below.

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12. Mr. Murphy of Barr Brothers, appellant's witness, likewise emphasized the importance of the "bottom line." A 991.

1. *Bondholders are fully protected*

a. *The objective protections.* General Solicitor Goldberg's compendious view of the effect of the many bondholder protections is helpful. Speaking to the Executive Staff of the Authority in October 1961, *before the enactment of the covenant,* Mr. Goldberg emphasized that Port Authority revenues could not be used to "subsidize the private railroads to the extent of their commuter operating deficits." A 839. Mr. Zarin, the Port Authority's Chief of the Finance Division of the Law Department, A 1004, concurred in that view at trial. A 1047-1050. In other words, the covenant was redundant in so far as it purported to prevent the Port Authority from giving its revenues to others for the benefit of railroads, and appellant does not contend otherwise.

Mr. Goldberg continued:

> "However there still was a fear in the financial community that the Port Authority might somehow take *into* its General Reserve Fund family a group of deficit-ridden railroads and then, by having gotten the disease into our own financial body, be in a position legally to apply our monies to their operating and debt service deficits. The fear was that in some such way we might actually dilute our earning and reserve position to a point where we would no longer have the financial capacity to meet the requirements of the existing bonds and of any other bonds we might have to put out for our self-supporting projects.
>
> "We in the Law Department have always held the firm opinion that the Port Authority *lacks* the power so to dilute the security of its bondholders, and we have advised the Commissioners to that effect. . . ." A 839.

Notwithstanding this legal opinion, Mr. Goldberg said, the Authority added the certification requirement to Section 7 of its Series Resolutions to make it absolutely clear that its bondholders' security could not be impaired by the acquisition of "deficit-ridden railroads." A 839-840. It will

be recalled that Section 7, see pages 9-10, *supra,* places the Port Authority under a contractual duty not to issue Consolidated Bonds for an additional facility unless it can certify compliance with three conditions: that the issuance of the bonds will not "materially impair the sound credit standing of the Authority"; that issuance will not materially impair "the investment status of Consolidated Bonds"; and that issuance will not materially impair "the ability of the Authority to fulfill its commitments, whether statutory or contractual or reasonably incidental thereto, including its undertakings to the holders of Consolidated Bonds." All three conditions must be met. A 1053.

Thus, before the covenant was enacted, the Port Authority could not give its revenues or reserves to others to subsidize mass transit and it could not itself undertake any mass transit projects that might endanger the bondholders' security. Mr. Goldberg was unequivocal on the point; the trial court agreed, A 127-128; and the complex web of bondholder protections that existed in 1961 fully supports their conclusion.

The main strands in that web are the General Reserve Fund, the Consolidated Bond Resolution of 1952, and the Series Resolutions. They combine to dedicate all revenues and reserves of the Port Authority for the benefit of bondholders. Hence Mr. Goldberg's undisputed conclusion that the Authority cannot give its resources away.[13] The Au-

13. The General Reserve Fund may only be used for "purposes in connection with bonds secured by a pledge of the General Reserve Fund . . . ." A 287. The Consolidated Bond Resolution pledges the net revenues from each facility financed by the issuance of Consolidated Bonds to the payment of debt service on all Consolidated Bonds. A 789-791. It creates the Consolidated Bond Reserve Fund, which it likewise pledges as security for Consolidated Bonds. A 795-797. The first paragraph of Section 7 of the Series Resolution, A 810-811, prevents the application of any part of this fund for the payment of operating deficits of a facility acquired without the issuance of Consolidated Bonds. See also A 1050. In 1962, there was nothing in the Consolidated Bond Reserve Fund. It began to grow in the years immediately preceding repeal, increasing from $7.1 million in 1972 to $21.9 million in 1973 and $46.8 million in 1974. A 500, 518. Total Port Authority reserves exceeded one-quarter of a billion dollars at the end of 1974. *Id.*

thority can apply its revenues or reserves to pay the deficits of a railroad only if it first issues bonds secured by the General Reserve Fund to finance that railroad. And the Authority can only do that if it meets the requirements of the Section 7 certification.

Even then, the Authority still could not issue a Consolidated Bond without also meeting the 1.3 test of the Consolidated Bond Resolution. A 75-76, 784-788. In 1961, Mr. Goldberg described the purpose and operation of the 1.3 this way:

> "And so he [the bondholder] must be sure that the Port Authority is not able to dilute the net revenue potential of the facilities to a point where the money that is going to come in—this gross revenue box that we start off with at the head of each column in the revenue flow chart—is going to get too small for the O&M and the debt service that it has to cover. He wants to be sure that we don't balloon the amount of our bonds up so big and get our debt service up so big and, in the case of a facility which wouldn't be carrying itself, like a Hudson & Manhattan Railroad, even get its operation and maintenance expenses up so big, that there wouldn't be enough overall to meet the debt service on his bonds and on the new bonds that might be put out in connection with new facilities.
>
> "Now the mechanism by which this insurance was given was the 1.3 earnings test. All this test is is a requirement that the Port Authority will not issue new Consolidated Bonds unless it can show, at each point of time it proposes to issue new consolidated bonds, that certain earnings equal 130 per cent of, or 1.3 times certain debt service on certain bonds. For the most part, the earnings that are used in this equation are historical earnings. They are the best twelve months out of the previous thirty-six months and in practice these have always been the last year, which has always been our best year. In certain limited instances we can augment these historical earnings with some estimates, but for the most part you

> can think of the earnings that we have to use in this test as historical earnings.
>
> "On the other side of the equation is the debt service—that is the interest, the amortization on the bonds, the annual maturities, the sinking fund requirements—which we must cover 1.3 times out of these earnings. This debt service is the requirement for that year in the future when our scheduled debt service will be at a maximum. In other words, we must take our peak demand year in the future for combined debt service on already-issued bonds and the proposed new bonds. We know our scheduled sinking fund and principal maturities; we know our scheduled interest requirements. We look up the schedule to figure out in which year in the future our scheduled debt service will be the heaviest, and then we compare this with our historical earnings, and if we can't show that the maximum future year's debt service requirements have been met historically in one of the past three years 1.3 times, we can't issue a Consolidated Bond." A 833-834.

When a deficit facility is acquired or built its losses are counted in determining whether the revenues from all of the Authority's facilities equal or exceed 1.3 times maximum future debt service. A 76. Similarly, debt service attributable to the new facility must be taken into account. In other words, the deficit must be subtracted from the revenue side of the equation and the new debt service must be added to the debt service side of the equation. As a result, no deficit facility can be brought into the Consolidated Bond "family" unless there is a healthy margin of net revenues from all Port Authority facilities in excess of actual debt service.

Other bondholder protections to be found in the Consolidated Bond Resolution but not in appellant's brief

include the Authority's obligation under Section 12(f), A 799:

> "To establish and collect flight fees, wharfage, dockage, rents, tolls and other charges in connection with facilities the net revenues of which are pledged as security for Consolidated Bonds, to the end that at least sufficient net revenues may be produced therefrom at all times to provide for the debt service upon all Consolidated Bonds."

To paraphrase Section 12(f) of the Consolidated Bond Resolution, the Authority is contractually obliged to run in the black. To take over or build a facility that would impose deficits so large that increases in tolls and charges could not carry them would violate Section 12(f) as well as the various provisions discussed above.[14]

The 1962 covenant added nothing to these protections. As the foregoing discussion makes clear, the Port Authority is contractually obliged to maintain reserves for the protection of bondholders, to have a healthy margin of revenues over debt service before issuing bonds and to refrain from issuing bonds to build or acquire a new facility if to do so will materially impair the Authority's credit standing, the investment status of its bonds or its ability to fulfill its commitments. These provisions make it impossible for the Authority to take over a passenger railroad that would jeopardize the security of bondholders.

To be sure, the covenant did constitute a significant impediment to Port Authority involvement in rail mass transit, but, viewed objectively, it added to the impediments

14. Other bondholder protections found in the Series Resolutions include provision for sinking fund payments and schedules of mandatory periodic retirement of bonds. Stip., Ex. II, pp. 74-75 in Volume V of the Joint Appendix below.

posed by the pre-existing protections only by blocking rail mass transit that does not threaten bondholder security.[15]

b. *Appellant's analysis of the objective protections.* Appellant attacks the importance of the 1.3 test by suggesting, first, that the test would not apply if the Authority issued bonds other than Consolidated Bonds, A.B. 30 & n.18, and, second, that the test does not consider prospective operating deficits of a new facility, A.B. 30-31 and 33 n.20. Both arguments are untenable.

If the non-Consolidated Bonds are secured by a pledge of the General Reserve Fund,[16] and are issued to acquire a new facility, the Section 7 certification would still have to be made. Moreover, no non-Consolidated Bond secured by

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15. The 1962 Legislature was not advised of this conclusion to which Mr. Goldberg's analysis the year before inexorably led. See A 838-840. No Authority spokesman attempted to explain the objective importance of the covenant, *i.e.*, what it added to existing safeguards. On the contrary, the Authority simply stated, A 86, that it would not certify the H & M Railroad under Section 7 unless the covenant was enacted and claimed, A 87, that it could sell no bonds without the covenant.

The Farley Committee's 1963 report concluded accordingly:

> "This Committee was convinced that the *credit problem which had been pointed out by the Port of New York Authority* was a valid and real one and that the Port Authority could not assume *responsibility for the complete burden of the deficit-ridden commuter railroad problem* in the area of northern New Jersey and New York. If the Port Authority were to receive *such unrestricted responsibility,* there is no question but that its sound credit position would be seriously impaired, if not destroyed . . . ." A 655; emphasis added.

The Farley Committee was not advised of the many existing protections against assumption of "the complete burden" or "unrestricted responsibility" for commuter rail deficits. Thus, the Farley Committee supported the covenant, unaware that the risks the covenant was supposed to avoid were already blocked.

16. If the non-Consolidated Bonds are not secured by a pledge of the General Reserve Fund, none of the revenues or reserves of the Authority's present facilities could be used to pay those bonds or to support the facility financed by them. Such bonds would have no effect on current bondholders.

a pledge of the General Reserve Fund has been offered since the Authority began issuing Consolidated Bonds in 1952 and, as appellant says, A.B. 30 n.18, the Authority has stated its intention to issue only Consolidated Bonds. Finally, Sections 4 and 5 of the Consolidated Bond Resolution pledge the net revenues of all of the Authority's facilities to the payment of debt service upon Consolidated Bonds. A 789-791. As a result, no revenues from the Authority's existing facilities would be available for payment of debt service on non-Consolidated Bonds until the debt service on Consolidated Bonds was paid. Consequently, non-Consolidated Bonds would be marketable only if purchasers were confident that the Port Authority would continue to generate revenues well above all operating expenses and debt service—*i.e.*, something akin to the 1.3 test. These points were recognized by Mr. Goldberg in 1961:

> "[T]he things the States direct the Port Authority to do these days are not capable of immediate self-support. So we are practically restricted to Consolidated Bonds and the 1.3 test." A 834.

Appellant's suggestions, A.B. 30-31 and 33 n.20, that the 1.3 test may not protect against operating deficits of a new facility fail to mention that the trial court specifically held that "the estimated average annual *deficits* of a new facility must be charged against historical revenues in determining whether the 1.3 test has been met." A 76; emphasis in original.[17] But even if appellant were right and the Port Authority Commissioners could somehow escape counting the deficits of a new facility at the time they begin to build

17. Judge Gelman's analysis was clearly correct, for as Vice Chairman Kellogg told the Farley Committee, the 1.3 test precludes the issuance of Consolidated Bonds "for any facility unless it can be demonstrated that, *including the new facility,* net revenues will be sufficient to cover by at least 1.3 times the maximum interest and principal payments due in any future year." A 87.

it, after it goes into operation its deficits will be counted in future applications of the 1.3 test. As Mr. Goldberg put it,

> "At the point where we can only show barely 1.3 or a whisker under 1.3, we can't put out Consolidated Bonds. The 1.3 status is not prosperity to us; it is practically the point of enforced stagnation. It is the point at which our ability to finance any future projects, even any capital improvements to existing facilities, ceases. For the Port Authority to continue as a healthy, vigorous organization, doing the job it was set up to do and which it has done so well in the past, we must keep our coverage up as high as we can." A 836.

Since the building of a facility that would generate deficits large enough to cause future difficulty with the 1.3 test would bring the Port Authority to "the point of enforced stagnation," end its "ability to finance any future projects," and endanger the Port Authority "as a healthy, vigorous organization," the building of such a facility would obviously run afoul of the Section 7 certification requirements. The Authority could not, consistent with its contractual commitment to bondholders, certify that the issuance of bonds for such a facility would not "materially impair the sound credit standing of the Authority or the investment status of Consolidated Bonds or the ability of the Authority to fulfill its commitments."[18]

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18. In its reply to our motion to dismiss, appellant claimed in its footnote at page 3 that according to the Port Authority's financial expert, Mr. Zarin, "*only* the 1962 covenant would prevent a Port Authority takeover of the Second Avenue subway line." But Mr. Zarin's testimony on this point was limited to the 1.3 test, which he believed would not apply, and "absent all other protections which exist, which we are not talking about," such as Section 7. A 1030-1031. And appellant neglected to advise the Court of the trial court's holding that the 1.3 test would itself apply to such a proposal. With good reason, appellant does not repeat this argument in its brief on the merits.

Appellant next attacks the Section 7 certification itself, A.B. 31-35, though in quoting Mr. Goldberg at page 33, it omits his immediately following statement that the certification requirement "has helped to allay the fears of the financial community," A 840, fears related directly to deficit rail mass transit, A 839-840. Appellant says first that the certification requirement could be avoided by manipulative legislative definition, arguing that this was attempted in 1971 and that, "It was the Covenant, therefore, which protected the bondholders, not Section 7." A.B. 33. In fact, it was bond counsel who "protected" the bondholders, A 692, and nothing in appellant's argument suggests that bond counsel could not, in the future, "protect" the bondholders by opining that, legislative definitions notwithstanding, a Section 7 "additional facility" is an "additional facility." See A 100.

Following a brief complaint that Section 7 blocks only a "material impairment" and not "any impairment" and its incomplete quotation from Mr. Goldberg, appellant continues its attack on the Section 7 certification by claiming that "Unlike the Section 7 certification, the 1962 covenant requires certification of an ascertainable amount. . . ." A.B. 34. Appellant is incorrect. According to the statute, it is enough to certify simply "that said other railroad facility is self-supporting."[19] And Mr. Zarin, though questioned at length on this precise point by appellant's counsel, specifically declined to testify that the 1962 covenant requires the certification of an amount when a facility is certified as "self-supporting." A 1082-1083.

Appellant goes on to argue that a covenant certification "requires considerably more precise a calculation" because it would be for "a single proposed facility," whereas a Section 7 certification would be for many facilities. A.B. 34. The fallacy is tempting, but a fallacy nonetheless: if

19. See N.J.S.A. 32:1-35.55, subdivision (iv) under "Permitted purposes."

the calculations for the many-facility certification are off, it must be because calculations for one or more individual facilities are off, and it is just as likely that the railroad calculations are wrong. Indeed, in many contexts, projections for a group of enterprises are regarded as more dependable than projections for a single enterprise.[20] At best, the benefit claimed by appellant is marginal, uncertain and contrary to the pooling concept that has been the basis of the Authority's financial success since the General Reserve Fund statutes of 1931 and the Consolidated Bond Resolution of 1952. See A 736. The trial court was clearly right in giving this argument "little weight." A.B. 34.

Appellant continues to argue that the covenant's use of "self-supporting" is more precise than Section 7's use of "materially impair" by quoting at length from Mr. Thompson's testimony, including his statement:

> "Now, self supporting, Your Honor—although it sounds as though it can be a qualitative phrase is not, at least not in our business." A.B. 35.

Mr. Thompson also testified that "self supporting means that the revenues shall be *estimated* to be at least as much as the operating expenses plus the debt service *which is a mathematical requirement* . . . ." A.B. 35; emphasis added.

Mr. Thompson's belief that "self-supporting" is a precise phrase has been emphatically rejected by the Farley Committee, by the Port Authority, and by its independent

20. The Port Authority may well provide such a context in view of the necessarily arbitrary way that it allocates its substantial general and administrative expenses and debt service among its facilities. See Stip., Ex. IV at Volume VI of the Joint Appendix below. Appellant admits that the Authority's single facility estimates for the Hudson & Manhattan were way off, A.B. 14, 15, 67. The record shows that the Authority's estimates for the construction of the World Trade Center were off by about $700 million. *Compare* A 182 *with* A 486. Yet the Authority as a whole has had great financial success—Barr Brothers calling it "one of the finest revenue credits in the country" even after the trial court's decision sustaining repeal, A 422-423.

auditors. Because the concept is "arbitrary" and "not based on actual fact," the Authority's accounting procedures do not use it. A 650-651, 660, 735a2-736. As Peat, Marwick, Mitchell & Co. put it,

> "The Authority's financial structure is based on a single enterprise, pooling of revenues concept. Individual facilities are not financed independent of the rest of the Authority. The facilities contribute their revenues for debt service according to their earning power without regard to the amount of bonds which were issued for their construction. For these reasons any presentation of net revenues after debt service for individual facilities is not based on actual fact. As pointed out by the Authority in submitting its report, such a presentation can only be based on arbitrary assumptions." A 651.

Thus, the ground on which appellant claims the covenant to be a greater bondholder protection than Section 7 literally does not exist.

Appellant's only other attempt to demonstrate the objective importance of the covenant is its assertion that it would have prevented the Port Authority's financial participation in the PATH-Plainfield project, which, says appellant, A.B. 35-36, is "presently estimated to require a diversion of pledged revenues and reserves of at least $128.4 million. (R-Ja 255-1)." The argument is confusing because based on a plan that was rejected by the federal Urban Mass Transportation Administration and not on the plan currently before that agency for approval. See A 527-528, pp. 60-62, *infra*. But even assuming that the now rejected plan can be considered as the type of plan that bondholders can expect, it is clear that they will not be hurt. Appellant's argument gives no weight to the fact that the actual source of the Port Authority's participation is the more than $40 million in annual revenues that the Authority has already begun to collect as a result of the toll increase instituted in

May 1975 for the specific purpose of financing mass transportation projects. See A405-407, 419-421, 503, 528.[21] In three or four years, the Port Authority will have earned the entire $128.4 million even though it will have spent far less. Significantly, appellant does not suggest that the toll increase would be justified or appropriate if, contrary to the Port Authority's public announcements, cited above, the increased revenues were not applied to financing mass transportation.

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21. Extraordinary as it may seem, appellant attempts to show that the $40 million does not exist. A.B. 38. For example, it invents something it calls "surplus reserves in excess of mandated bonded debt service" and asserts that its creature grew by only $296,000 in 1975. In support of its analysis, appellant invites the Court's attention generally to the 39-page 1975 Annual Report of the Port Authority, citing three cases for the proposition that the Court may employ judicial notice to that end. No page or chart of the Report itself is cited.

The relevant portions of the Port Authority's 1975 Report are set forth in the Appendix, A 503-518. They show that in 1975, the Authority's gross operating revenues rose from $410.4 million to $458.4 million, a gain of $48 million, A 511, 515; that net revenues available for debt service and reserves after payment of operating expenses rose from $181.4 million to $200.9 million, a gain of more than $19 million, A 515; that the General Reserve Fund increased from $173.4 million to $176.4 million, a gain of $3 million, A 518; that the Consolidated Bond Reserve Fund grew from $46.8 million to $62.4 million, a gain of more than $15 million, *id.;* that the Authority's total assets grew from $3.186 billion after depreciation to $3.249 billion after depreciation, a gain of approximately $63 million, A 513; since total liabilities rose by less than $7 million, net assets grew by $56 million, *id.* It is worth remembering too that 1976 will be the first *full* year in which the toll increases have been in effect.

Appellant emphasizes that operating expenses also rose by over $37 million, "more than consuming any new revenues resulting from the toll increases," A.B. 38. Very little of that increase in expenses, however, is attributable to bridges and tunnels. Since appellant does admit that the Authority's net operating revenues and reserves did in fact increase, it appears to have charged all increases in costs at all of the Port Authority's facilities against the toll rises, instead of following the accepted procedure of charging each facility's operating expenses against its operating revenues. This bit of creative accounting is no more supportable than the rest of appellant's analysis.

c. *The subjective fears.* Appellant's case rests not on what the covenant objectively added to bondholder protection, but on misinformation and unfounded fears.

Appellant offered only one witness to testify about the circumstances surrounding the enactment of the 1962 covenant—John F. Thompson, Vice President of W. H. Morton and Company. A 844. Mr. Thompson testified that in 1961, "[M]y reaction to the Port Authority getting into that [the Hudson and Manhattan] or other mass transit was one of concern because the Port Authority has always gone into projects which it could reasonably ascertain that they would become self-supporting, at least within a period of a few years of development and this seemed to be a different tack for the Port Authority to start on." A 855. Mr. Thompson amplified on cross-examination, A 959-960:

> "A. The facilities acquired or constructed up to then had all been expected eventually to become self-supporting. H & M was not.
>
> Q. Self supporting at what point in the future?
>
> A. Within a reasonable time, within three, four, or five years.
>
> Q. Were those expectations fulfilled, to your knowledge? . . .
>
> A. I am not sure that my facility knowledge of the Port operation is sufficient to give you a full and accurate answer. I have understood that one or two facilities from time to time have not done as well as hoped, but on the whole the reverse is true. . . .
>
> Q. So your assumption that the Port Authority's moving from what had been almost entirely, with one or two exceptions, profitable enterprises to mass transit was a major factor in your concern about the acquisition of the Hudson and Manhattan?
>
> A. Yes, it was a factor of concern."

Mr. Thompson was thoroughly misinformed. As of December 31, 1960, the Staten Island Bridges had been in deficit for 22 years, the Port Authority Building for 21, and

Newark Airport for 13. Of all Port Authority facilities, only the piers and Port Newark had run at a deficit for as few as 3 or 4 years. Everything else had been in deficit for at least 7 years and most had been in the red for 10 years or longer. A 691.[22]

Mr. Thompson testified next that "if one step were made into mass transit, the question arose in the minds of most participants in the investment community, what comes next, what other projects in mass transit will next be undertaken." A 855-856. On cross-examination, however, he was unable to answer whether most investors knew that the covenant did not prevent the Port Authority from operating bus lines at a deficit. A 961.

Mr. Thompson also testified that he had never considered the fact that the covenant leaves the Port Authority exposed to massive deficits ten years after certification of a passenger railroad under the covenant. A 943-944. He did not believe bondholders needed covenant protection against that risk: he was content to rely on the good faith of the States, A 945, the unwillingness of the Port Authority to go along, A 947, and the resistance of the bond market, A 946.

The point is important. The protection actually afforded by the covenant is far more modest than Mr. Thompson and the other witnesses understood. It could be satisfied by simple agreement between the Governors and the Port Authority Commissioners that a facility would be self-supporting. Even though a railroad were expected to run

22. And see A77n. 15: "For the calendar year 1973, of the 22 facilities operated by the Authority, 14 were operated at a deficit." See A 397.

That appellant's chief witness was so totally misinformed about the deficits of individual facilities further demonstrates that appellant is wrong in urging, A.B. 5-8, the importance of the concept that each facility be self-supporting by itself. If that concept had any importance, Mr. Thompson would have known about the long deficit history endured by each of the Authority's major facilities.

at a deficit, that agreement would satisfy the covenant's definition of "self-supporting" if it were backed up by the agreement of the States to pay the deficits for ten years *and no longer*. The covenant's definition of "self-supporting" would also be satisfied if the States agreed to continue their payments for more than ten years but at the same level paid during the first ten years, leaving the long-term growth in the deficit for the Port Authority to absorb.

As Mr. Thompson acknowledged, it was not the covenant that protected against these hazards, but other bondholder protections. He noted the unwillingness of the States to inflict actual damage on bondholders, the parallel concern of the Port Authority and the pressure of the bond market, three formidable safeguards. The Section 7 certification, among others, is germane too.

Mr. Thompson also believed the covenant's definition of "self-supporting" to be a "mathematical requirement," A.B. 35, though he admitted that it was based on "estimated" revenues, A.B. 35, and though the Farley Committee, independent auditors and the Port Authority all recognized it could "not be based on actual fact" but only "arbitrary assumption." A 651.

Not only was Mr. Thompson misinformed about or ignorant of the actual meaning of the covenant and the Authority's history of successfully carrying deficit facilities; he was also unaware that other bondholder protections fully protected against his fears. Thus, he believed that the covenant was necessary to prevent "the possibility of massive deficit operations getting into the Port structure" and "that if the Port Authority were given a white elephant that all of the revenues of the Port operation, operating revenue, would be pooled in order to support that before debt service would be paid." A 949. The witness repeated the point at A 942, and concluded cross-examination on this question by testifying that, "I believe

that this is one situation that might arise that makes the covenant important." A 956.

Mr. Thompson obviously did not understand that his opinion was ill-founded and that even without the covenant "massive deficit operations" could not get "into the Port structure," for the reasons explained by Mr. Goldberg before the enactment of the covenant, A 838-840. Nor did Mr. Thompson understand that, as Mr. Zarin testified, A 1050, Section 7 of the Series Resolutions prohibits the use of the reserve fund to pay the operating deficit of a facility acquired without the issuance of Consolidated Bonds, *i.e.*, a "white elephant."

No wonder Mr. Thompson considered the 1962 covenant "an important and significant part of what I presumed we were buying for our clients." A.B. 23, A 873. He was misinformed about the precision of the "self-supporting" concept, the facilities history of the Authority and its ability to undertake many deficit operations, and the many other protections against any deficit operation that would threaten bondholder security.[23]

Mr. Thompson was the only witness offered to testify about the circumstances surounding the enactment of the covenant as well as the only witness offered by appellant who purported to have any detailed knowledge of the workings of the covenant or its relationship to other bondholder protections. It follows that the record is barren of evidence that anyone informed about the rights of bondholders in the 1961-62 period regarded the covenant as important to

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23. As *Amicus* S.I.A. says at page 13, Mr. Thompson was also the witness who testified "that if the Governor of New Jersey had recommended repeal of the covenant *before* the sale of $300,000,000 of bonds of the New Jersey Sports and Exposition Authority instead of one week *after* the sale, the bonds would not have been saleable. . . ." This was not only Mr. Thompson's personal opinion; he "heard no professional investment person who disagreed with this." *Amicus* 14. The sale of the Sports and Exposition Authority bonds was held on January 18, 1974. As appellant's brief correctly notes, Governor Byrne proposed repeal as early as June 1973. A.B. 27, n.16.

bondholders.[24] The evidence that Mr. Tobin sought the covenant to further his views of the Port Authority's mission is corroborated by the objective unimportance of the covenant. See A 108-109.

2. *The Authority's consistently high credit rating demonstrates the unimportance of the covenant and repeal*

The trial court found that the "limited role of the covenant on the Authority's credit standing is also reflected in the ratings assigned to Port Authority bonds by the principal ratings services, Moody's and Standard and Poor's." A 110. The Moody's and Standard and Poor's ratings for Port Authority bonds have been and are "A," meaning that "they are of investment quality and no default in payment of principal or interest is anticipated." A 110, 849.[25] The bonds had that rating before the covenant was enacted, after it was enacted, after it was prospectively repealed, after the repeal at issue in this lawsuit, A 110, 750-763, and after the decisions below, A 481-500, 1123-1131.

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24. No officer or employee of appellant testified, nor did appellant offer any of its purchase or sale records to show that the covenant had any bearing on its transactions in Port Authority bonds.

In an attempt to make up for the missing evidence, appellant refers, at A.B. 12 n.9, to the deposition of its Executive Vice President even though that deposition *was not admitted into evidence*. The trial court's ruling excluding it, A 1121-1122, was clearly proper and has not been appealed to this Court.

Had appellant's Executive Vice President testified, he would have been exposed to cross-examination about his approval of an April 1974 internal memorandum stating: "Efforts to repeal the 1962 covenant by legislative action should not be viewed with alarm." E454.

25. Thus, this is emphatically not a case in which the obligor "unilaterally" decides that default is improbable. Compare A.B. 67. Appellant has never alleged or offered any evidence to show that the Authority's bonds are in any danger of default whatsoever and the Barr Brothers report issued after the trial court's decision sustaining repeal concludes that the Authority's bonds offer "secure value for the investor," A 423.

In arriving at its "A" rating, Moody's has always given full weight to the prospect of deeper Port Authority involvement in passenger railroads. As early as February 1972, it recognized the relevance to the Port Authority of the increase in Triborough vehicular tolls to support rail mass transit. A 258-259. Its June 1973 report referred specifically to the enactment of bi-State legislation pursuant to which "the Authority will contribute to the capital cost of passenger rail projects." The report, rating the 40th series "A," continues: "In addition, this new legislation amends 1962 statutes which served as the basis for a statutory covenant limiting the Authority's ability to participate in deficit passenger railroad projects. These deficit limitations will not apply to the holders of bonds hereafter issued by the Authority, including these bonds." A 264-265.

The Moody's report for October 5, 1973, A 750-751, rates the 41st series "A," while noting "the clouded future surrounding . . . the role, if any, which Port Authority will play in a regional mass transportation system." The two-paragraph summary on the front page of the report also notes that a "suit now in the Supreme Court of New York State seeks to permit unlimited application of surplus Authority funds to deficit passenger railroads. *If the suit is successful,* demands for mass transportation would probably obstruct further Authority expansion into other fields. *Bondholder protection would remain adequate, because debt service constitutes a first lien on net revenues.*" A 750-751; emphasis added. Thus, even on the express assumption that the covenant would be struck down, Moody's adhered to its high rating of Port Authority bonds.

Within two weeks after the trial court's decision sustaining repeal of the covenant, leading investment advisers agreed with the opinion that repeal was not material. Thus,

Barr Brothers & Co., one of the three largest dealers in Port Authority bonds, A 978, issued a report specifically referring to the trial court's decision, summarizing the other bondholder protections and the great financial strength of the Port Authority, and concluding:

> "Whether or not the Port Authority ever gets involved in Mass Transit, we feel it continues to be one of the finest revenue credits in the country, amply protected by the basic bond resolution, excellent management and some highly profitable and monopolistic facilities that can more than carry a reasonable amount of Mass Transit, particularly with the recent toll increases on the Hudson crossings providing additional revenues." A 422-423.

This report is from a firm that is a member of the class represented by appellant and from which it selected one of its three expert witnesses.

In June 1975, the month after the trial court's decision, Standard & Poor's and Moody's each confirmed the continuation of the Port Authority's "A" rating. Standard & Poor's, while expressing a concern about the effect of future Port Authority involvment in mass transit, says: *"Despite this concern, we are continuing our 'A' rating on the Port Authority's Consolidated Bonds and are also rating the new Consolidated Notes 'A' based upon the Authority's strong operating, financial and management record and the prospect for a continuation of this outstanding record."* A 482; original all in emphasis. Moody's, also referring to the trial court's opinion, continues its "A" rating on Port Authority obligations because "earnings of the present facilities are good, reserves for debt service continue strong, and recent toll increases have further strengthened its financial position at this time." A 484-485.

In July 1976, the Port Authority issued its 42nd series of Consolidated Bonds. Standard & Poor's simply continued its "A" rating without writing a new report. A 1124.

Moody's continued its "A" rating in a report stating that while the decisions in this case "are a matter of deep concern to bondholders generally," in so far as the Port Authority is concerned, "earnings of the present facilities are good and reserves for debt service continue strong." A 1126.

That the Port Authority's high credit rating accurately reflects the objective unimportance of the covenant is further demonstrated by S-36, an 8-page single-spaced publication of Blyth & Co. on the 36th series issued in November 1970. A 279-292. Blyth & Co. advises the reader that the series is intended to finance "capital expenditures in connection with the Authority's airports, docks, wharves, *mass commuting facilities* . . . ." A 280; emphasis added. The Section 7 certification requirement is set forth, the 1.3 test is duly noted, Sections 4 and 5 of the Consolidated Bond Resolution are paraphrased, the Consolidated Bond Reserve Fund is described, the General Reserve Fund and its 10 percent requirement are discussed at length, various covenants are summarized, including the Authority's promise to set charges high enough to cover debt service, *but not a word is said about the 1962 covenant.*

S-36 is not unusual in regarding the covenant as too unimportant to mention. See, for example, S-22 (J. B. Hanauer & Co.), S-42 (Bankers Trust) and S-35 (Blyth & Co.), all in Volume II of the Joint Appendix below.

3. *The unimportance of the covenant and repeal in the secondary market*

Between 1952 and 1962, the Port Authority sold 19 series of bonds, worth hundreds of millions of dollars, without the covenant. A 108. Throughout this period, various public officials and agencies were calling for greater Port Authority participation in rapid transit. A 576-671. While appellant claims without record support that these efforts were all "illusory," A.B. 30, that claim is belied by the Authority's

need to extract the "Memorandum of Understanding" from the MRTC, amend Section 7 in 1958 to add the certification requirement and constantly drum up "bondholder concern"; the claim is also inconsistent with the 1959 New Jersey Assembly report that appellant simply mischaracterizes. See p. 16 and n.10, *supra.*

On March 25, 1961, legislation requiring the Port Authority to take over the Hudson & Manhattan Railroad and containing no covenant was passed by the New York Legislature. A 90. Governor Rockefeller signed the legislation on April 6, 1961. The secondary market for Port bonds was unaffected. A 381-384.

In early January 1962, if appellant's protestations are to be believed, investor concern should have been at its height. At its previous session, the New York Legislature had adopted legislation requiring the Authority to take over the H & M; the Port Authority had announced in September 1961 that it might agree to do so if certain assurances could be obtained, A 622, but the Authority had yet to receive those assurances. Dun and Bradstreet, taking note of all this, nonetheless rated the Port Authority's prospects as "Superior," A 171, and the Nineteenth series was sold on January 4, 1962 without difficulty at an interest rate of 3½ percent. A 108.

Between 1962 and May 1973, the Port Authority issued 20 series of Consolidated Bonds at interest rates ranging from 3¼ percent to 6⅝ percent. A 110. Though the Port Authority was now operating a passenger railroad with substantial deficits and the covenant might or might not endure,[26] bondholder enthusiasm for Port bonds continued unabated.

In 1973, New Jersey and New York enacted legislation repealing the covenant with respect to bonds issued after

26. Appellant's chief witness, Mr. Thompson, testified that he was aware at all relevant times that under certain circumstances a State may constitutionally abrogate its contracts and that other pledges had been repudiated. A 950-951, 952.

May 10, 1973. A 102-103. In June 1973, the Port Authority issued its 40th series of Consolidated Bonds at an interest rate of 6 percent. Though the covenant did not apply, appellant exercised its discretion to buy $2,570,000 of 40th series bonds for its fiduciary accounts. A 1120.

In October 1973, as New Jersey's gubernatorial race was nearing its end, the Port Authority issued $100 million of its 41st series of Consolidated Bonds. Though the covenant did not apply to these bonds and candidate Byrne had, as appellant claims, called for greater participation by the Authority in mass transportation, the bonds were sold at an interest rate of 5½ percent. A 110-111. In light of these undisputed facts, the trial court properly concluded:

> "[I]t is clear that the interest rates which the Authority has had to pay on non-affected bonds [the 40th and 41st series] were not materially affected by the absence of direct covenant protection." A 111.

At the trial, appellant attempted to show that the repeal of the covenant adversely affected the secondary market for Port Authority bonds. After a careful evaluation of the live testimony and comprehensive documentary evidence submitted to him, the trial court concluded:

> "The bottom line of plaintiff's proofs on this issue is simply that the evidence fails to demonstrate that the secondary market price of Authority bonds was adversely affected by the repeal of the covenant, except for a short-term fall-off in price the effect of which has now been dissipated insofar as it can be related to the enactment of the repeal." A 112-113.

While appellant attacks this finding at length, A.B. 38 to 47, it simply cannot overcome the fact that at the time of trial the prices for bonds of the Port Authority of New York and New Jersey and of the Massachusetts Port Authority (an agency selected for comparison by appellant, A 209-215) bore exactly the same relationship to each other

that they did when appellant's charts began (July 1973) and immediately prior to the repeal of the covenant. A 111-112, 210-211, 243, 1119. Even as of August 4, 1976, the spread between Mass. Ports and New York Ports was the same as it had been in July 1973, April 1974 and February 1975. A 1131.

Appellant's statement, A.B. 41, that the "sharp rise" in Port Authority bond prices "in January 1975" was "caused by purchases to cover short sales in the preceding month" demonstrates, if anything, that the prices were artificially low at the end of 1974, when appellant's charts as submitted during Mr. Thompson's testimony end, see A 210-211, 213-214. Appellant's further characterization of the relationship between the bond prices of New York Ports and Mass. Ports as a "short term technical situation," A.B. 43, is, respectfully, ridiculous since the relationship has remained the same in the 18 months since trial, A 1131.[27]

Appellant also would have the Court believe that "the quoted bid prices for the Port Authority bonds since the repeal are artificially high, because, as noted above, an attempted sale of any block of Port Authority bonds, which could have been sold at the quoted price prior to repeal, would now force the quoted prices substantially lower."

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27. Appellant complains, A.B. 44, that the trial court ignored evidence relating to Kansas Turnpike and Indiana Toll Road bonds, the only issues selected for comparison by Mr. Murphy, A 988, from "roughly two hundred issues" in which he maintains an active market. A 975. But the evidence cited in the text demonstrates that the bonds of the Port Authority of New York and New Jersey behaved no differently vis-a-vis the Kansas and Indiana bonds than did the bonds of the Massachusetts Port Authority. See also A 989-991 (toll road agencies, unlike the Port Authority, do not have one-third of their assets invested in a real estate market that was severely depressed in 1974, nor do they have major investments in airports that were hit hard by the sharp drop in air traffic in 1974). Moreover, the two toll road bonds selected by Mr. Murphy went up sharply in price in mid-1974, accounting for the entire increase in the spread between the toll road bonds and the New York-New Jersey and Massachusetts Port bonds, while the rest of the bond market was declining. A 992-993.

A.B. 41. The disproof of this pudding occurred in July and August 1976 when the Authority issued its $100,000,000 42nd series. Though Mr. Thompson had testified that his calculations showed that a new issue of Port Authority bonds "would immediately drop the secondary market for all other Port issues . . . by some 6 to 10 points," A 940, in the month following issuance of the 42nd series, the prices of all three New York Port bonds quoted in *The New York Times increased,* A 1131, and the new bonds, offered through a syndicate including many of the nation's largest investment houses, quickly sold out at a premium. A 1124.

Appellant further complains, A.B. 40, that the trial court "ignored the expert testimony with respect to the 'thinness' of the market," though it admits two pages later, A.B. 42, that the trial court "referred to the testimony as to the thinness of the market." In fact, appellant's evidence on this point was contradictory and internally inconsistent. Appellant's witnesses, having been sequestered, testified that: (1) after repeal, people could not buy Port bonds because nobody would sell; (2) after repeal, people could not sell their Port bonds because nobody would buy; and (3) there was a rush of selling. Thus, Mr. Thompson testified that "all of the professional investors I know" decided to hold on to their Ports. "As a consequence the flow of bonds into the market is much less than it normally would be." A 879. Mr. Fitzgerald testified that immediately after repeal, "there was a reasonable amount of selling, but . . . to have had the selling, you would have to have people who are willing to stand up and buy bonds as well . . .," A 1100, and after repeal investors would no longer buy Port bonds. A 1092-1093. And Mr. Murphy testified that, "the size of the market I would say immediately after the repeal was quite active. I would say that there was substantial selling of Port Authority bonds. As time went on, it became increasingly heavier, particularly at the end of the year, because a number of institutions and fiduciaries availed

themselves of the opportunity of selling Port bonds to establish tax losses." A 984. Presumably they were selling to somebody.

In the face of this conflicting testimony, appellant's failure to offer any records documenting the volume of purchases and sales of Port Authority bonds, and the evidence showing no adverse effect on market prices, the trial court properly found that repeal of the covenant had no significant adverse effect on the secondary market for Port Authority bonds. A 112-113.[28]

F. Legislative History of the Repeal of the 1962 Covenant

Appellant objects to the above heading in the trial court's opinion, A 98, as "misleading because there is, in fact, no legislative history attendant upon the repeal of the 1962 Covenant." A.B. 26-27 n.16. In fact, as the record demonstrates, the years immediately preceding repeal saw repeated and extensive legislative consideration of the vital question of the Port Authority's role in rail mass transit. Relevant legislation was enacted in both States in 1971, in New York in 1972, in both States in 1973 and again in 1974. A 629, 703-707. The introducer's statement annexed to New Jersey's repeal of the covenant refers specifically to the 1972 legislation. A 103, 773. Similarly, during the 1974 legislative debate on New York's repeal, explicit reference was made to the efforts over the prior four years to increase the Port Authority's participation in rail mass

28. Though much of the testimony of appellant's experts about the market for Port bonds was conflicting and contradictory, there was no disagreement about one proposition. In response to requests for advice about whether to buy Port bonds, Mr. Thompson testified: "With regard to purchase, I simply for the most part agreed with them that it wasn't a very wise thing to in effect buy into a lawsuit." A 882. If anything has happened to the market for Port Authority bonds, even though the prices do not reflect it and appellant's experts disagree over what it is, investor reluctance to buy into a lawsuit offers a classical explanation.

transit, A 769, 771-772. This four-year effort was also cited in the October 1975 report of a Joint New Jersey Legislative Committee investigating the Port Authority. A 164.

1. *The energy crisis*

In early 1974, while repeal of the 1962 covenant was before the Legislatures of New Jersey and New York, both States and, indeed, the entire nation, were in the throes of a paralyzing energy crisis.[29] On November 27, 1973, Congress had enacted the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. sections 751 *et seq.*, directing the President to promulgate regulations for the mandatory allocation and pricing of crude oil and refined petroleum products. 15 U.S.C. section 753(a). In enacting this statute, Congress specifically found that the hardships caused by the oil shortage:

> "jeopardize the normal flow of commerce and constitute a national energy crisis which is a threat to the public health, safety, and welfare." 15 U.S.C. section 751(e).

On January 14, 1974, the Federal Energy Office promulgated its Mandatory Petroleum Allocation and Pricing Regulations for monthly allocations of gasoline. The January and February 1974 allocations to New Jersey and New York were totally inadequate to meet the demand for gaso-

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29. Appellant claims that the repeal was proposed by then-candidate Byrne "in June, 1973, well before the energy crisis." A.B. 27 n. 16. In fact, as early as April 18, 1973, there were Presidential Proclamations establishing the National Energy Office and attempting to reduce oil imports, see 38 Fed. Reg. pp. 9645, 9657; by June 1973, Governor Love of Colorado had been appointed to head the Energy Policy Office and the President had released a lengthy statement on the nation's energy resource problem. See *N.Y. Times*, June 30, 1973, pp. 1, 20; 38 Fed. Reg. p. 17711.

In any event, the evil existing *at the time the Legislature acted* is obviously the controlling factor, and appellant concedes that the nation was afflicted by a grave energy crisis in 1974, A.B. 56.

line in those States. The result was chaos, as most service stations closed and the few that remained open were besieged by long lines of motorists. A 552-553. Local law enforcement, first aid and fire fighting personnel were inadequately supplied, while ordinary citizens immobilized by the lack of gasoline and suitable public transportation alternatives could not go to work, shop for necessary food supplies or obtain medical service. *Id.*

The legislation repealing the 1962 covenant was introduced on February 15, 1974, A 434, 763 n., at the very height of the energy crisis. Eleven days earlier, the New Jersey Legislature had enacted the Emergency Energy Fair Practices Act of 1974, which found "that an energy shortage now exists and may continue for the foreseeable future"; ten days earlier, Governor Byrne, in his first Executive Order, had proclaimed that an energy emergency existed. A 551-552.[30]

Though there is no shortage of gasoline in the State of New Jersey at the moment, there was a desperate shortage immediately before the Legislatures acted and that shortage could recur at any time. Moreover, the enduring effects and implications of the energy crisis are very much with us now, as Congress and the President continue to wrestle

30. Appellant's contention that there was no publicly expressed relationship between the repeal of the 1962 covenant and the energy crisis, A.B. 56, 66, is disingenuous. As shown by the articles appearing at A 425-438, on February 12, 1974, New Jersey Department of Transportation officials appeared before the I.C.C. to protest the Port Authority's request, in the middle of the energy crisis, for a 66% increase in the PATH fare. One or more Commissioners of the Authority thereupon threatened to withdraw Port Authority support for new rail mass transit projects that the Authority and the States had been hoping could satisfy the covenant. New Jersey's bill to repeal the 1962 covenant was introduced within two days of this threat.

The relationship between repeal and the energy crisis was also expressly noted in the New York legislative debate. See pp. 49-50, *infra.* And, of course, the relationship between legislation permitting increased support for mass transit and the energy crisis was obvious to everyone concerned.

with measures to reduce our dependence on foreign oil. On February 21, 1974, President Nixon discussed the long-range and "no less difficult" problem the nation would face when the oil embargo ended and observed: "It is now widely recognized that the development of better mass transit systems may be one of the key solutions to both our energy and environmental problems." A 106, 555-556.

Congress has repeatedly agreed. For example, the Regional Rail Reorganization Act of 1973, enacted on January 2, 1974, contains specific findings that "rail service and rail transportation offer economic and environmental advantages with respect to . . . energy efficiency and conservation . . . to such extent that the preservation and maintenance of adequate and efficient rail service is in the national interest," and that "railroads are one of the most energy-efficient modes of transportation for the movement of passengers and freight." A 107, 547-549. See also the Energy Supply and Environmental Coordination Act of 1974, 15 U.S.C. sections 791 *et seq.;* and the National Mass Transportation Assistance Act of 1974, A 99 n. 29, 719-723. During the debate on the last of these statutes in late 1974, Congressman Minish of New Jersey, one of its principal sponsors, reminded Congress:

> "With our present energy situation and the threat of a renewed crisis in this area, the need for mass transit aid has become ever more critical. Buses and rail cars consume only a fraction of the energy that a private automobile does, yet we cannot expect the commuting public to reduce significantly its use of private cars if we do not provide suitable alternative sources of transportation." A 721.

See also the statements of Senator Williams of New Jersey and Representative Abzug of New York at A 720-721, 722-723.

The energy crisis, which was totally unexpected when the covenant was enacted in 1962, made it essential that the

States invoke their police power to facilitate greater participation by the Port Authority in the development of rail mass transit. The Port Authority, absent the covenant, is in a unique position to impose higher costs upon the cars using its bridges and tunnels, thereby discouraging their use, and to apply the increased revenues from the higher tolls to improved and expanded rail mass transit. The Port Authority was, after all, founded upon the understanding that great benefits would accrue from *coordinated* transportation in the Port District.

The energy implications of this coordinated approach are obvious and were recognized by appellant's chief witness, John Thompson, when he wrote to *The New York Times* on May 1, 1974, the day after Governor Byrne signed New Jersey's repeal:

> "A broad view of urban and energy problems suggests that government should act to discourage auto traffic into major cities in favor of the greater use of mass transit. This would probably involve a sizable shift of funds from charges imposed on automobile traffic to the support of mass transit; to do this is an exercise of the state police power, and it should be done in this instance by the two States themselves, and applied to all automobile traffic entering Manhattan." A 245-246.[31]

Just a few days earlier, Assembyman Koppell had told the New York State Assembly during its debate on repeal that:

> "If anything indicates the necessity of increased funds for mass transportation, it is the energy crisis

31. If, as appellant claims, A.B. 56, 66, the relationship between repeal and the energy crisis is mere coincidence and after-thought, it is curious that appellant's chief witness made the connection publicly and immediately and that he recognized the need for an exercise of the States' police power. *Barron's* too observed immediately that the covenant "has fallen victim to the energy crisis." Ja90.

> in which we are involved and which threatens our whole society. I think this legislation is critical. I think this legislation is certainly one of the most important things that we can do today, and is undoubtedly one of the most important steps that we can take to improve mass transportation." A771.[32]

The 1962 covenant, enacted in an era of cheap and plentiful oil, became a harmful anachronism in the very different world of 1974. See A 769.

2. *Health and environmental factors*

The early seventies were also a time of unprecedented efforts to alleviate the health hazards associated with air pollution, efforts of a scope and magnitude unknown in 1962. The federal Clean Air Act Amendments of 1970, 42 U.S.C. sections 1857 *et seq.*, provided major impetus. They authorized the Administrator of the federal Environmental Protection Agency to establish national air quality standards and to prescribe, upon the failure of a State to do so, the steps necessary to achieve compliance with those standards. A 105.

The technical background with respect to the federal air quality standards for carbon monoxide is summarized at A 561-564; hydrocarbons are discussed at A 564-565. Briefly, the National Air Pollution Control Administration found that even low concentrations of carbon monoxide affect the senses and produce undesirable cardiovascular

32. In the face of this statement, which is included in the Stipulation and which we have repeatedly cited in the courts below, the first footnote on page 7 of appellant's reply to our motion to dismiss said: "Not one legislator from either state, nor either Governor, publicly expressed the most casual connection between retroactive repeal of the 1962 Covenant and any energy or environmental problem." The second numbered paragraph at A.B. 56 continues to imply strongly, but erroneously, that no reference was made to the energy crisis during the legislative debate on repeal.

changes. A 561-562. With respect to hydrocarbons, it found that their presence in the air causes irritation of the eyes, upper respiratory tract and skin, visibility reduction and vegetation and material damage. A 564. As for the source of the pollutants, the studies are consistent. In the New York Metropolitan area, an estimated 95.5 per cent of all carbon monoxide emissions come from transportation. A 561.[33] Motor vehicles are responsible for 49 per cent of hydrocarbon emissions. A 564. Automobile exhaust emissions are "the primary source of air pollution in the City of New York." A 104.

On November 13, 1973, after the State of New Jersey failed to present an acceptable plan for achieving compliance with the national air quality standards for hydrocarbons and carbon monoxide, the Administrator of the federal Environmental Protection Agency promulgated regulations designed to achieve a 67 percent reduction in hydrocarbon emissions and a 47 percent reduction in carbon monoxide emissions in the northern part of New Jersey. A 105; 38 Fed. Reg. 31388 *et seq.*[34] The federally mandated plan for New Jersey includes the "application of certain transportation control measures including a requirement for a significant reduction in vehicle miles traveled." A 105; 38 Fed. Reg. 31389.

The Administrator stated that although the Environmental Protection Agency attempted to avoid the imposition of "impractical" measures in 1977, the year by which the State was to be in compliance, "a regulation has been

33. In *Friends of the Earth* v. *Carey,* 535 F.2d 165, 180 (2d Cir. 1976), the court observed that carbon monoxide air pollution in New York City has "climbed to over five times the federal health standards." The court ordered enforcement of a federal EPA plan calling for, among other things, the imposition of tolls on the free vehicular bridges into Manhattan. 535 F.2d at 171 n. 7, 180.

34. The parties stipulated that judicial notice could be taken of these regulations, A 567, and they have not been reproduced in the record.

included to limit gasoline sales in 1977, but it will be used only if the standards have not been attained by these other measures." 38 Fed. Reg. 31389.

As the trial court observed, A 105, the Administrator emphasized the importance of the development of mass transit to the improvement of New Jersey's air quality:

> "The development of large-scale mass transit facilities and the expansion and modification of existing mass transit facilities is essential to any effort to reduce automotive pollution through reductions in vehicle use. . . . Many improvements are being planned in mass transit facilities in the State that will make it possible for more people to use mass transit instead of automobiles. . . .
>
> "The Administrator actively supports the immediate and large-scale purchase of additional public transportation facilities, including additional buses and an expansion and improvement in the available rail transit system. The Administrator also encourages close examination of such measures as fare reductions, State taxes to encourage VMT [vehicle miles traveled] reductions while raising revenue to benefit mass transit, . . . elimination of commuter discounts on toll facilities in the affected Regions, and possibly an increase in tolls during peak commuting times to encourage carpools." 38 Fed. Reg. 31389.

The 1962 covenant was at cross-purposes with the Administrator's position. By its terms, the covenant impeded the "development of large-scale mass transit facilities and the expansion and modification of existing mass transit facilities," which the Administrator called "essential to any effort to reduce automotive pollution through reductions in vehicle use." And given the robust health of the Port Authority's revenues and reserves, the Federal Highway Administrator would probably disap-

prove,[35] and the Governors would never have approved, any increased tolls on Port Authority bridges and tunnels, as suggested by the Environmental Protection Administrator, unless some of the new revenue were applied to support rail mass transit. Yet the covenant, as interpreted by Mr. Tobin to the Legislatures in 1971, precluded the use of increased vehicular tolls for rail mass transit. A 689.

3. *The Port District's public transportation requirements*

The pivotal importance of adequate passenger rail transportation to the welfare and economy of the State of New Jersey has never been denied by appellant. See A.B. 66, where appellant finally admits:

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35. The tolls charged on the Authority's bridges are subject to the Bridge Act of 1906, 34 Stat. 84, 33 U.S.C. §491 *et seq.*, which provides that the tolls charged "shall be reasonable and just." The Federal Highway Administrator is authorized to prescribe such tolls. 32 Fed. Reg. 5607, 49 C.F.R. §148(i)(1). In the *Delaware River Port Authority* case discussed at A 724-726, the Administrator said that "a reasonable and just toll schedule would be one sufficient to support" all of the Authority's activities, including a rail mass transit line, A725, and referred to "the urgent need to structure toll rates for crossings in major metropolitan areas to encourage use of mass transit and carpools," A 726. The Administrator's order reducing tolls was subsequently vacated by the Court of Appeals for insufficient findings with respect to whether the reduced tolls would permit the Authority to sustain its "total activities." *Delaware River Port Auth. v. Tiemann,* 531 F.2d 699 (3d Cir. 1976).

In July 1974, the federal Department of Transportation, which includes the Federal Highway Administration, concluded in a report to Congress that:

> "in some areas (New York, Philadelphia, San Francisco), bridge toll revenues provide significant support for transit capital and/or operating costs, thereby providing transit service improvements which promote decreased dependence on automobile travel. Therefore, it would appear to be in the Federal interest to permit the imposition of tolls which would promote a more efficient utilization of the urban transportation system. Such a policy would not be unjustly discriminatory but more appropriately reflect the total costs of using the facility in peak demand periods." A 726-727.

> "If it can be said in the case at bar that the ends to be accomplished are improvement in mass transit, decrease in air pollution and conservation of energy, it must be granted that they are legitimate."

Even a brief review of the massive record demonstrates that these were precisely the ends to be served by repeal.

Prior to 1962, public concern with rail mass transit in the Port District produced little more than a stream of studies and reports. A 79-80, 605. While these reports portrayed in graphic terms the continuing deterioration of rail mass transit in the Port District—a condition to which the vehicular facilities developed by the Port Authority directly contributed, A 604, see Stip., pp. 96, 100, 108, 134-135, 139, 140-141, 154; Ex. VII, pp. 125A-126A, 130A-133A —no significant steps were taken to improve the situation until the early 1960's. A 80. Thus, when the 1962 covenant was enacted, no one knew what could actually, rather than theoretically, be accomplished by coordinated support of rail mass transit in the Port District.

Since 1962, the public attitude and policy has changed dramatically from "Why Worry?" A 601. By September 1973, the State of New Jersey had committed more than $350 million to its program, modestly begun in 1960, to maintain and improve commuter rail services. Stip., pp. 15, 144.

In New York, it was found, contrary to the 1958 report of the Metropolitan Rapid Transit Commission, Stip., pp. 109-110, upon which appellant relies at A.B. 8-9, that financial support could be obtained from existing public authorities. In addition to the Port Authority's modernization and operation of the Hudson & Manhattan (now PATH), surplus revenues of the Triborough Bridge and Tunnel Authority, including additional surpluses created by the doubling of tolls on vehicular bridges and tunnels, were applied to the deficits of subways and passenger railroads. During the

seven years prior to the end of 1974, the Triborough turned over approximately $305 million to the New York Metropolitan Transportation Authority to help support rail mass transit. A 732.

Despite this substantial infusion of funds in the years since 1962, the plight of the commuter railroads within the Port District remains critical, as the Court knows. See *Blanchette* v. *Connecticut Gen. Ins. Co.,* 419 U.S. 102, 108, 156, 159 (1974). Beginning in 1967, each of the four private companies operating commuter rail services in New Jersey has been involved in reorganization proceedings under the federal bankruptcy laws. A 81 n.21. The express policy of the State of New Jersey has been to impress upon the federal courts supervising the reorganization proceedings the necessity of continuing most of these rail services. A 546. The most recent comprehensive program of the New Jersey Department of Transportation, published in September 1973, explained the reasons for this policy:

> "Cessation of mass transportation services in these urban areas would produce intolerable conditions on the personal lives of the residents of the areas. The State is now directed by the federal government to reduce the levels of air pollution in these areas to a significant degree within the next five years. It has been determined that the existing basic rail and bus systems will fail within the next few years unless a major investment in capital facilities, equipment, and operating subsidies is provided by the public." A 546-547.

By 1970, it had become apparent that although it had revitalized the Hudson & Manhattan, the Port Authority had not kept pace either with its ability or with the need to increase its participation in rail mass transportation. Thus, in April 1970, Governors Cahill and Rockefeller announced a joint program to expand the Authority's role in rail mass transit by having it build a rail link to Kennedy Airport and

extend PATH to Newark Airport and other parts of New Jersey. A 99-100, 686.

In March 1971, legislative committees of both New York and New Jersey held joint hearings on the relationship of the Port Authority to mass transportation. The committees heard testimony, summarized at A 687-690, see further Stip. pp. 223-233, and Stip., Ex. VII, from numerous witnesses, including several recognized experts, to the following effect: the Port Authority had substantial funds available in excess of required interest and principal payments; the Port Authority's revenues could be increased substantially by doubling the tolls on its bridges and tunnels;[36] the largest commercial bank in the Port District had released a report calling for the imposition of higher and economically more reasonable charges for the use of highways and river crossings in order to transfer badly needed revenues to rail mass transit; the covenant did not add to the security of Port Authority bondholders and was simply a condition that the Port Authority made to its assumption of responsibility for the Hudson & Manhattan; passenger rail ridership within the Port District had increased substantially as a result of massive highway congestion, which was also adversely affecting air quality and intelligent land planning and use; and the Port Authority had "subverted" the efforts of the Metropolitan Rapid Transit Commission as part of its long-range effort to avoid rail mass transit in favor of the lucrative development of vehicular facilities.

During the March 1971 joint legislative hearings, Mr. Tobin stated that even if vehicular tolls were doubled, the tens of millions in increased revenues "could not go under the law [to] mass transit anyway . . . we could use them for other facilities supported by the General Reserve Fund, but

36. Executive Director Tobin predicted that doubling the Authority's vehicular tolls would raise "holy political hell," A 688, a prophecy borne out by the reactions to the 1975 toll increase discussed at A.B. 37-38. The fact remains that despite these reactions the toll increase is in effect. A 528.

you could not, under the law and the constitution, use them for mass transit facilities." A 689. The obvious barrier was the 1962 covenant.

In the light of this evidence, there was extensive discussion during the 1971 joint legislative hearings concerning possible repeal of the 1962 covenant. Assemblyman Koppell of New York asked whether the covenant could be repealed "not only for the future, but for the past" on the basis of the legislative finding "that in the exercise of our right to protect the people of the two states, we find that this covenant stands in the way of the proper development of mass transportation facilities, which is essential to the people's good and welfare." A 689.

The covenant was not repealed in 1971. Instead, after the hearings, the Legislatures tried a different course. In June 1971, they enacted bi-State legislation authorizing the Port Authority to extend passenger rail transportation to Kennedy Airport and to Newark Airport and Cranford. A 100, 692. In enacting these statutes, see Chapter 245 of the Laws of New Jersey, 1971, N.J.S.A. 32:1-35.20 *et seq.*, the Legislatures made detailed findings concerning the importance of rail access to the airports. They declared that, "Additional highway construction to serve these great airports is not feasible and creates severe problems in terms of increased air pollution . . .," that rail access "must be" provided if the Port Authority airports are "to continue to serve the economic well-being" of the area, and that "such an undertaking is found and determined to be in the public interest."

The June 1971 legislation sought to avoid the limitations of the covenant by characterizing the proposed rail links "as constituting a part of each air terminal." A 100, N.J.S.A. 32:1-35.3. However, while this legislation was pending, the Port Authority obtained opinion letters from two New York firms, Hawkins, Delafield & Wood and Davis,

Polk & Wardwell, both of which concluded that the legislation would be "ineffective to remove the facilities of the Project from the ambit of the Covenant." A 100, 692.

In December 1971, the First Boston Corporation submitted a report to the Port Authority concerning the financing of the airport rail links authorized by the June 1971 legislation. A 692-702. The report noted that "the essential problem" confronting the airport rail links "is created in the statutes and resolutions by which the Port Authority is bound; and particularly the joint State covenants of 1962, which in effect prohibit the Port Authority's involvement in additional passenger rail transportation projects unless they are self-supporting." A 692. The study stated flatly that the 1962 covenant "precludes general credit financing of any passenger transportation project, no matter how desirable, for which projections show an operating profit below debt service requirements." *Id.*

In June 1972, the New York Legislature adopted, and Governor Rockefeller signed, a bill repealing the 1962 covenant. New Jersey did not adopt similar legislation at that time. A 101-102.

In November 1972, Governors Cahill and Rockefeller announced agreement on a major plan of rail mass transportation development for the Port District. A 102, 705. The Governors proposed the extension of PATH via Newark Airport to Plainfield, direct rail service from Kennedy Airport to New York City and direct rail service to Pennsylvania Station in New York City for riders of the Erie Lackawanna Railroad.

Commenting on the environmental, energy and traffic effects of the PATH-Plainfield project, the Port Authority stated:

> "Based on 1985 traffic estimates, the PATH extension to Plainfield will generate about 9 million auto-

> mobile and bus miles in travel to and from Corridor stations. By contrast, if rail service is abandoned in the Corridor, an estimated 46.5 million auto and bus miles would be required yearly on the roads leading to Newark and New York City. The saving of 37.5 million vehicle miles per year will result in less highway congestion and less air pollution. In addition, it will be far more efficient in terms of the utilization of scarce energy resources." A 715-716.

The plan was incorporated in bi-State legislation that also repealed the covenant prospectively. A 102-103; Ch. 208 of the Laws of N.J., 1972, N.J.S.A. 32:1-35.51 *et seq.;* Ch. 318 of the Laws of N.Y., 1973.

The estimated cost of the plan was $650 million, and it was said that the Port Authority would invest between $250 and $300 million for these vital projects. A 102-103; see also A 385. It was also said that these projects would be self-supporting, but if any deficits were to materialize, they would be the Port Authority's responsibility. The 1972 Annual Report of the Port Authority stated that the necessary steps were being taken "so that construction might begin as soon as possible in 1973 on one or more of the projects. The program is expected to be completed by the end of 1977." A 386-387. Nevertheless, the covenant prevented the Port Authority from proceeding to construction of these legislatively authorized projects. The Port Authority could not participate in the financing of a passenger rail project unless that project's estimated net revenues were themselves sufficient to carry its debt service. The condition proved to be an insuperable obstacle.

As appellant states, A.B. 17 n. 14, in 1972 it was said that the PATH-Plainfield part of the package might be financed within the terms of the 1962 covenant through a federal grant of $150 million, Port Authority participation of $50 million and an advance of up to $40 million by the State of

New Jersey, to be repaid by the Port Authority. But it soon became apparent that this plan was not feasible.[37] The Authority's application for federal funds, filed in April 1974 just before repeal of the covenant, was rejected by the federal Urban Mass Transportation Administration because it failed to include the necessary certification of how the local financial share would be obtained. A 717. See also A 393-394.

G. Post-repeal Plans for Financing Mass Transit

With the covenant repealed, the Port Authority could plan and act to finance PATH-Plainfield sensibly and without any impairment of bondholder security. On April 10, 1975, the Authority announced a proposed increase in its basic bridge and tunnel tolls (which had remained constant since 1927) to raise an estimated $40 million per year to be used to help finance the PATH-Plainfield project, the Kennedy rail link, the Erie Lackawanna direct access plan and an expansion of the Port Authority Bus Terminal. See A 405-407, 419-421, 528.

The "historic revision" of Port Authority bridge and tunnel tolls, A 439, 503, expressly effected "to increase its ability to finance vital mass transit improvements," A 405, went into effect on May 5, 1975. The trial court's decision sustaining the repeal of the covenant issued on May 14,

37. In December 1972, the Director of the Port Authority's Department of Rail Transportation told an Information Session of the New Jersey Senate that PATH-Plainfield was "barely doable on a self-sustaining basis," even if the most optimistic assumptions were made. A 708-709. By 1975, after a sharp increase in the estimated cost of the project from $252 million to $347 million, A 398-399, it was clear that $40 million from the State would not do the job. New Jersey's Transportation Commissioner said so and proposed that the State assume responsibility for operating deficits. A 477. This is the position appellant characterizes as a unilateral election to renege. A.B. 18, 36.

1975. On May 23, 1975, the Port Authority submitted a revised application to the Urban Mass Transportation Administration for $277.6 million in federal funds for the PATH-Plainfield project, certifying that the 20 per cent local share of the capital cost of the project, $69.4 million, would be obtained from the proceeds of Port Authority bond sales, with the State agreeing to finance any operating deficit. A 527. The covenant would have blocked this plan because the net revenues of the project are unlikely to equal debt service. The difference between the two will be made up by increased tolls on auto traffic. The speed with which the Port Authority was able to act in April and May 1975 contrasts sharply with its inability to certify the financing of the local share of the PATH-Plainfield project so long as the 1962 covenant remained in effect. A 717.

In December 1975, the Urban Mass Transportation Administration initially rejected the PATH-Plainfield application. A 527-528, 1132-1135. The State then submitted a revised and more comprehensive financing plan, still pending before UMTA, pursuant to which the Port Authority's capital share of the PATH-Plainfield application was increased to $120 million. A 1139. Appellant agrees that this plan too would have been blocked by the covenant. A. B. 36. Since the Port Authority calculates that the increased toll revenues can support debt service on $400 million in new bonds, without any threat to bondholder security, the Authority is also planning a $160 million expansion of the Port Authority Bus Terminal and up to $120 million for mass transportation improvements in New York. A 528.

The foregoing package will actually *enhance* bondholder security while freeing many millions of dollars for mass transit. The toll rise has been generating over $40 million in new revenue for more than a year. See A 528. Though the Port Authority has begun work on the bus terminal expansion, several years will pass before the Authority will

be spending anything like $40 million per year on debt service for these projects. Since bridge toll hikes are subject to federal approval and federal policy strongly supports the application of revenues from interstate vehicular bridges to rail mass transit, see pp. 52-53, *supra,* and since the Governors would not otherwise have approved the toll increase, the extra bond reserves provided by the immediate increase in tolls could only have been obtained by linkage to a rail project.

Thus, repeal permitted a coordinated transportation program. The fare rise has an automobile-discouraging potential. The increased revenues support mass transit. Air quality will be improved, energy conserved. And bondholders are not harmed.

SUMMARY OF ARGUMENT

In the courts below, eight judges reviewed appellant's claim that the States acted arbitrarily and capriciously in repealing the 1962 covenant. Not one found merit in it. As the Counter-Statement above shows, repeal permitted the States to respond rationally to their critical need for more mass transit, a need that was dramatically emphasized in 1974 when gasoline shortages produced economic chaos and vast disruptions of life in communities without mass transit alternatives. Moreover, the best scientific data available revealed that pollution caused by automobiles in the densely populated New York-New Jersey Metropolitan area has a corrosive effect on human health. As appellant now recognizes, A.B. 66, "These problems can only be attacked by reducing vehicular traffic partially through the improvement of mass transit."

Legislation responsive to an existing public health menace and to an unprecedented energy shortage that threatened the economic foundation of the State comes before the Court entitled to a maximum of respect. These are clearly

paramount State interests, *United States* v. *Little Lake Misere Land Co.*, 412 U.S. 580, 606 n.2 (1973) Stewart, J., concurring).

Since appellant now admits that those paramount interests can be advanced only "by reducing vehicular traffic partially through the improvement of mass transit," and since the covenant was a serious obstacle to precisely that course, it follows that repeal of the covenant would have been constitutional even if it inflicted substantial harm on bondholders. Yet, as the Counter-Statement also shows, the private loss in this case is trivial at most. The States' repeal of the covenant in no way impairs the central undertaking that principal and interest be paid when due. Nor does repeal materially affect the security that supports that promised repayment; indeed, appellant does not allege that there is any likelihood that the bonds will not be timely paid.

The immateriality of the covenant to bondholders' economic interests is evidenced by every objective measure—whether it be the test of the market place, analysis of the tight web of bondholder protections discussed above, or the Port Authority's huge reserves fed by ever-growing revenues.

Faced with a record that fully supports these assertions, appellant chooses to deny here a proposition it conceded below: that State contracts are subject to legislative action under the State's police power.[38] In reversing

38. See, *e.g.*, appellant's reply brief in the Supreme Court of New Jersey 38: "Defendants' dissertation on the evolution of the case law interpreting the Contract Clause is superfluous since plaintiff *has never denied that the State may modify the provisions of a contract under the color of the police power* in the proper circumstances" (emphasis added); appellant's trial brief 14-15: "in rare instances a State's contract may be constitutionally abrogated by a proper exercise of the State's never abdicated police powers" and the reasonableness of the State's action is then to be determined by balancing the interests to be served against the harm done.

itself, appellant misstates the history of the contract clause, misreads this Court's relevant precedents and advances arguments that are wrong in fact and untenable in law.

The law is clear that all contracts are subject to State police power. And the incontrovertible facts of this case establish that New Jersey's police power was reasonably exercised.

The State also maintains that the covenant is voidable, an alternative ground the courts below found it unnecessary to address.[39] This Court's precedents make it clear that the modification of a voidable contract does not violate the contract clause. The covenant was voidable because it improperly amended the Port Authority Compact without Congressional consent. Finally, the State contends that the covenant was invalid when repealed because of its inconsistency with supreme federal law in the transportation, environmental and energy fields. Acceptance of either of the State's alternative arguments requires affirmance of the judgment below.

ARGUMENT

I

THE 1962 COVENANT IS SUBJECT TO THE REASONABLE EXERCISE OF THE STATES' NEVER ABDICATED POLICE POWER.

Appellant's theory that State contracts, unlike private ones, are immune from legislative alteration pursuant to the police power, A.B. 48-54, or subject to special rules because the State benefits, A.B. 64, turns logic and constitutional history upside down.

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39. The argument was advanced at every stage of the proceedings below, A28-29, 129, 143, but the lower courts preferred to rest their decisions on the ground that repeal was a proper exercise of the State's police power.

A. The History of Contract Clause Jurisprudence Shows That All Contracts, Especially State Contracts, Are Subject to the State's Police Power.

The precise scope the contract clause was intended to have by the Constitution's framers is murky, if indeed a group so disparate shared any common intent. As Chief Justice Hughes noted in *Home Building & Loan Ass'n* v. *Blaisdell,* 290 U.S. 398, 427 (1934), "[T]he debates in the Constitutional Convention are of little aid." Moreover, unlike much of the Constitution's language, the phrase "impair the obligation of contract" has no common law antecedents to give it shape.

In any event, it is clear that the focus of the contract clause was *private* contracts, not public ones. As initially proposed to the Convention by Rufus King of Massachusetts, the clause was limited to them.[40] He took his language from the recently enacted Ordinance for the Northwest Territory, which precluded laws "that shall, in any manner whatsoever interfere with or affect private contracts, or engagements without fraud previously formed."[41] The broader language of the modern clause originated in the Convention's Committee on Style, and no debate informs us as to the reasons for the change. However, as Wright notes in THE CONTRACT CLAUSE AND THE CONSTITUTION 15-16 (1938), there is virtually no evidence that the clause was understood by the framers to apply to public contracts.

Despite the drafters' preoccupation with private contracts, the clause was held applicable to government obligations. *Fletcher* v. *Peck,* 10 U.S. (6 Cranch) 87 (1810); *Trustees of Dartmouth College* v. *Woodward,* 17 U.S. (4

40. II M. Farrand, Records of the Federal Constitution 439 (1911).

41. 44 Stat. 1851 (1926 Comp.).

Wheat.) 518 (1819). But contrary to appellant's presentation, the Court has always been more receptive to alterations of State contracts than private ones, because of the manifest public necessity that each succeeding legislature be empowered to respond to changing public needs. In time, the Marshall Court's rigid view of the contract clause as a barrier to nearly all retroactive legislation[42] had to yield to the expanding responsibilities of government.

The seeds of later views were sown early. First, in *Dartmouth College,* Marshall recognized that the clause was inapplicable to regulation by the States of their civil institutions;[43] second, in that same case Marshall and Story both noted that States could limit contract rights by express reservation; third, the Court ruled in *Proprietors of the Charles River Bridge* v. *Proprietors of the Warren Bridge,* 36 U.S. (11 Pet.) 420 (1837), that public grants were to be strictly construed against the grantee.

Fourth, and finally, there developed the doctrine of State police power—that the State must retain power to deal with certain public exigencies. As noted, the States could limit contract rights by express reservation, but even without such a reservation all contracts contain implied conditions intrinsic to the "obligation." For example, government must have continuing power to protect the morals and public health of its citizens. Such powers cannot be frozen

42. A view taken, it might be added, when no other basis for federal intervention against unreasonable State legislation existed. *Barron* v. *Baltimore,* 32 U.S. (7 Pet.) 243 (1833), held the Bill of Rights inapplicable to the States; *Calder* v. *Bull,* 3 U.S. (3 Dall.) 386 (1798), held the ex post facto clause inapplicable to civil legislation.

43. He observed, "That the framers of the constitution did not intend to restrain the states in the regulation of their civil institutions, adopted for internal government, and that the instrument they have given us is not to be so construed, may be admitted." 17 U.S. (4 Wheat.) at 629. The Port Authority is, of course, a "civil institution" of the States of New York and New Jersey.

by contract, particularly not by contracts made by one legislature that may be corrupt, misled or misinformed.[44] People who contract either know or ought to know that circumstances may eventuate during the life of a contract that require its alteration by the State. When such circumstances occur, exercise of the sovereign's power, while it may disappoint expectations, does not impermissibly impair any "obligation" of contract.

In *West River Bridge Co.* v. *Dix,* 47 U.S. (6 How.) 507, 532 (1848), upholding the condemnation by eminent domain of a franchise granted for a term of years, the Court set forth this theory of implied conditions:

> "But into all contracts, whether made between States and individuals or between individuals only, there enter conditions which arise not out of the literal terms of the contract itself; they are superinduced by the pre-existing and higher authority of the laws of nature, of nations, or of the community to which the parties belong; they are always presumed, and must be presumed, to be known and recognized by all, are binding upon all, and need never, therefore, be carried into express stipulation, for this could add nothing to their force. Every contract is made in subordination to them and must yield to their control, as conditions inherent and paramount, wherever a necessity for their execution shall occur."

There is, however, an important difference between implied conditions in private law and the implied conditions of sovereignty. Private parties can by the phrasing of their bargains control the scope of implied conditions, but one legislature, elected for a fixed term, has no power to bargain away central elements of State sovereignty so as to

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44. The wisdom underlying the doctrine is revealed by this case. We do not question that in 1962 the Port Authority's management sincerely believed in its vision of the Authority's role. It is equally clear, however, that the Authority imposed on the Legislatures in order to further that vision. See pp. 15-16, 20, 26 n.15, *supra.*

preclude their exercise by a future legislature. This is not to say that one legislature can never bind the next, for plainly it can to some extent despite the general presumption against such a construction. The point is rather that one legislature, holding the basic attributes of sovereignty in temporary trust, cannot deny them to the future.[45]

The point was given early expression in *Newton* v. *Board of County Commissioners,* 100 U.S. 548 (1880). There an 1846 Ohio law purported to contract, for good consideration, that a particular county seat would be located permanently in Canfield, Ohio. The law was held amenable to repeal. Justice Swayne said that on many matters the States were not competent to enter into binding contracts. These matters:

> "involve *public interests* and legislative Acts concerning them are, necessarily, *public laws.* Every succeeding Legislature possesses the same jurisdiction and power with respect to them as its predecessors. The latter have the same power of repeal and modification which the former had of enactment, neither more nor less." 100 U.S. at 559.

Soon after, the Court wrote in *Stone* v. *Mississippi,* 101 U.S. 814, 819 (1880), upholding the repeal of a lottery franchise:

> "The question is therefore, directly presented, whether, in view of these facts, the Legislature of a State can, by the charter of a lottery company, defeat the will of the people, authoritatively expressed, in relation to the further continuance of such business in their midst. We think it cannot. No Legislature can bargain away the public health or the public morals. The People themselves cannot do it, much

45. In *West River Bridge Co., supra,* the contract did not expressly preclude subsequent use of the State eminent domain power. In *Pennsylvania Hospital* v. *Philadelphia,* 245 U.S. 20 (1917), the contract was express and the Court held it invalid.

> less their servants. The supervision of both these subjects of governmental power is continuing in its nature, and they are to be dealt with as the special exigencies of the moment may require. Government is organized with a view to their preservation, and cannot devest itself of the power to provide for them. For this purpose, the largest legislative discretion is allowed, and the discretion cannot be parted with any more than the power itself."

The Court expressed the same principle, that on certain matters one legislature cannot bind another, in approving repeal of the New Orleans Butchers Monopoly in the second Slaughterhouse Case, *Butchers Union Co.* v. *Crescent City Co.*, 111 U.S. 746, 750-751 (1884):

> "The denial of this power, in the present instance, rests upon the ground that the power of the Legislature intended to be suspended is one so indispensable to the public welfare that it cannot be bargained away by contract. It is that well known but undefined power called the 'police power' . . . .
>
> "It cannot be permitted that, when the Constitution of a State, the fundamental law of the land, has imposed upon its Legislature the duty of guarding, by suitable laws, the health of its citizens, especially in crowded cities, and the protection of their person and property by suppressing and preventing crime, that the power which enables it to perform this duty can be sold, bargained away, under any circumstances, as if it were a mere privilege which the legislator could dispose of at his pleasure."

The issue is: what are these basic police powers inherent in sovereignty that cannot be bargained away? The early cases tended to answer with categories of State activity, *e.g.*, eminent domain, government institutions, protection of morals, protection of health, and regulation of key indus-

tries;[46] the later cases responded with an understanding that powers of government cannot be thus pigeonholed.[47]

46. The present case falls clearly within three of these, protection of health, change in civil institutions of government and regulation of key industries.

47. The trial court's opinion concisely summarizes the main cases before *Blaisdell,* A 119-120:

> "During the span of more than a century between *Ogden v. Saunders* [1827] and *Blaisdell* [1933] the court had held on numerous occasions that the states retained the power to impair contractual obligations—including those to which the state was a party—in the exercise of their always reserved police powers to act in the interest of the public health, safety and general welfare. First in dictum, *Boyd* v. *Alabama,* 94 U.S. 645, 650, 24 L. Ed. 302 (1877), and then by direct application of the doctrine, the court held that a lottery franchise granted for a definite term of years could be repealed. *Stone* v. *Mississippi,* 101 U.S. 814, 25 L. Ed. 1079 (1880); *Douglas* v. *Kentucky,* 168 U.S. 488, 18 S. Ct. 199, 42 L. Ed. 553 (1897). In *Northwestern Fertilizing Co.* v. *Hyde Park,* 97 U.S. 659, 24 L. Ed. 1036 (1878), it was held that a franchise to operate a fertilizer factory at a given location could be negated by the exercise of the police power to abate a nuisance. Similarly, the power to control the use of the public streets may not be bargained away, *Atlantic Coast Line R. Co.* v. *Goldsboro,* 232 U.S. 548, 34 S. Ct. 364, 58 L. Ed. 721 (1914); *Denver & Rio Grande R. Co.* v. *Denver,* 250 U.S. 241, 39 S. Ct. 450, 63 L. Ed. 958 (1919), nor can the state contractually bind itself not to exercise its power of eminent domain, *West River Bridge Co.* v. *Dix,* 47 U.S. (6 How.) 507, 12 L. Ed. 535 (1848); *Pennsylvania Hospital* v. *Philadelphia,* 245 U.S. 20, 38 S. Ct. 35, 62 L. Ed. 124 (1917), or to change the location of its governmental subdivisions, *Newton* v. *Mahoning County,* 100 U.S. 548, 25 L. Ed. 710 (1880). The broadest expression of this view of the police power during this period is to be found in *Chicago & Alton R.R.* v. *Tranberger,* 238 U.S. 67, 35 S. Ct. 678, 59 L. Ed. 1204 (1915), where Justice Pitney said:
>
> > 'It is established by repeated decisions of this court that neither of these provisions of the Federal Constitution [the Contract and Due Process Clauses] has the effect of overriding the power of the state to establish all regulations reasonably necessary to secure the health, safety, or general welfare of the community, that this power can neither be abdicated nor bargained away and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise***. And it is also settled that the police power embraces regulations designed to promote the public convenience or the general welfare and prosperity, as well as those in the interest of public health, morals or safety.' (238 U.S. at 76-77, 35 S. Ct. at 682)"

The State necessarily retains residual sovereign power to meet the needs of the people. What counts is whether the power is reasonably exercised.

The leading case in the transition is *Home Building & Loan Ass'n* v. *Blaisdell,* 290 U.S. 398 (1934). At issue there was the Minnesota Mortgage Moratorium Law, a statute that stopped creditors from exercising their time-honored, bargained-for rights to take possession of and sell the mortgaged property. Quite clearly, as the dissent asserted, the legislation did just what the contract clause was originally designed to prevent—provide emergency debtor relief. Nor could the law be thought a regulation of health or morals. These categories were not stretched but abandoned. Finding that the contract clause "is not an absolute one and is not to be read with literal exactness like a mathematical formula," the Court wrote:

> "Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order." 290 U.S. at 435.

In trying to limit *Blaisdell,* appellant emphasizes that the Minnesota law relieved private parties, not the State, of contractual duties. The difference was indeed noteworthy: in the past, States had frequently been allowed to repudiate their own promises; *Blaisdell* held that they could also interfere with private contracts when private distress rose to the level of public concern. Acceptable justification for legislation affecting contract rights was no longer limited to a handful of categories. Rather the reserved power of sovereignty had to be seen as a general principle, its exercise limited only by reasonableness and by a need to harmonize its exercise with the policy of contract protection.

In asserting that State contracts are immune from reasonable exercise of the State's police power, appellant simply ignores the ample authority to the contrary. Moreover, the cases it does cite, A. B. 50-53, have little bearing here. *Von Hoffman* v. *City of Quincy,* 71 U.S. (4 Wall.) 535 (1867), was a mandamus action to compel the levying of taxes to pay interest on bonds in default. *Wolff* v. *City of New Orleans,* 103 U.S. 358 (1880), and *Louisiana* v. *Pilsbury,* 105 U.S. 278 (1881), were also mandamus actions. In all three cases, the challenged legislation was invoked to evade the primary obligation—payment of interest or principal. Moreover, in *Quincy,* the Court recognized that remedies for enforcing bonds can be changed if no substantial right is lost:

> "It is competent for the States to change the form of the remedy, or to modify it otherwise, as they may see fit, provided no substantial right secured by the covenant is thereby impaired." 71 U.S. at 553.

The remedies to enforce a general obligation bond are in effect the bondholder's only legal protection: thus, in *Quincy,* the Court accepted the proposition that bondholder protections may be modified "provided no substantial right" is impaired.

While the venerability of *Wolff* v. *City of New Orleans, supra,* and *Louisiana* v. *Pilsbury, supra,* is not in question, their viability is another matter.[48] The Court's unanimous decision in *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502 (1942), upheld legislation that permitted a municipality to change the interest rate on its obligations and to extend their maturities over the objection of creditors. Whether the precise statutes at issue in *Wolff* or *Pilsbury* would today be upheld in light of *Faitoute* is immaterial. Appellant is just plain wrong when it claims, A. B.

48. Neither case was cited in any of appellant's numerous briefs to the courts below.

60-61, "It is settled, however, that a state may not impair its own contract with its citizens. The only exception to this rule is *City of El Paso* v. *Simmons*. . . ." See, *e.g., Butchers Union Co.* v. *Crescent City Co., supra,* 111 U.S. 746 (1884); *Pennsylvania Hospital* v. *Philadelphia, supra,* 245 U.S. 20 (1917); *Faitoute Iron & Steel Co.* v. *City of Asbury Park, supra; Levine* v. *Long Island R.R.,* 38 A.D.2d 936, 331 N.Y.S.2d 451 (2d Dep't), *aff'd,* 30 N.Y.2d 906, 335 N.Y.S.2d 565, *cert. denied,* 409 U.S. 1040 (1972). Leading State decisions include *New Jersey Sports & Exposition Auth.* v. *McCrane,* 61 N.J. 1, *appeal dismissed,* 409 U.S. 943 (1972); *Opinion of the Justices,* 334 Mass. 721, 136 N.E.2d 223 (1956). And see *Flushing Nat'l Bank* v. *Municipal Assistance Corp.,* A.D.2d , 382 N.Y.S.2d 764 (1st Dep't 1976).

Nor is appellant's argument that State and private contracts are treated differently supported by *Perry* v. *United States,* 294 U.S. 330 (1934), as the Court's rejection of the very same argument in *El Paso* v. *Simmons* indicates.[49] In *Perry,* Chief Justice Hughes opined that the United States could not alter the gold clauses in its own contracts. First, his opinion, joined by only three other Justices, is not properly characterized as an opinion of the Court on the very point disputed by Justice Stone, the fifth Justice concurring in the judgment. More importantly, the case has nothing to do with State police powers: appellant to the contrary notwithstanding, A.B. 54, there is no general federal police power.

The federal government is limited to the necessary and proper use of its delegated powers. The power to regulate the value of money and determine the value of currency, Chief Justice Hughes stated, did not include the power to repudiate obligations. His conclusion on that point was buttressed by a specific constitutional provision, the fourth

49. Mr. Justice Black urged the distinction in his dissent. 379 U.S. at 528.

section of the 14th amendment, which states that "the validity of the public debt of the United States, authorized by law . . . shall not be questioned." 294 U.S. at 354.

Finally, the Court rejected Perry's challenge to government action, for even if his contract was breached, he could show no damage, and this was the only ground on which a majority of the Court agreed.

B. Bondholders Could Not Reasonably Have Assumed That the 1962 Covenant Was Immune From Action Pursuant to the Police Power.

The covenant did not state that it was immune from the police power and its silence on this point should itself be dispositive. *See Proprietors of the Charles River Bridge Co.* v. *Proprietors of the Warren Bridge Co.,* 36 U.S. (11 Pet.) 420 (1837); *Rogers Park Water Co.* v. *Fergus,* 180 U.S. 624 (1901).

By the time of the covenant's enactment in 1962, the Court had left no doubt that "every contract is made subject to the implied condition that its fulfillment may be frustrated by a proper exercise of the police power." *Indiana ex rel. Anderson* v. *Brand,* 303 U.S. 95, 108 (1938). A host of prior cases, cited above, establishes that this formulation included public contracts; *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502 (1942), made clear that it extended to municipal bond contracts.

New Jersey law was equally clear. In *Hourigan* v. *North Bergen Township,* 113 N.J.L. 143, 149 (E. & A. 1934), a case involving municipal bonds, New Jersey's highest court declared:

> "It as a well established doctrine that the interdiction of statutes impairing the obligation of contracts does not prevent the state from exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts entered into between individuals may thereby be affected. This power, which in its various ramifications is known as the police power, is an exercise of the sovereign right

> of the government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals. While this power is subject to limitations in certain cases, there is a wide discretion on the part of the legislature in determining what is and what is not necessary—a discretion which courts ordinarily will not interfere with."

The applicability of these principles to the covenant itself is obvious. Article VII of the Port Authority Compact permits the States to add to the duties of the Port Authority if and when they choose to do so. All bondholders purchasing bonds knew or should have known of that basic aspect of the Authority's legal structure. See Section 12(a) of the Consolidated Bond Resolution, A 797. Moreover, Senator Farley, on whose Committee Report appellant puts such stress, speaking specifically of the covenant, warned that "one Legislature cannot bind a subsequent Legislature involving policy." See A 88-90.[50]

The leading opinion as of 1962 on the nature of port authority revenue bonds said the same thing. *Opinion of the Justices,* 334 Mass. 271, 136 N.E.2d 223 (1956). The Supreme Judicial Court of Massachusetts, under its procedure for issuing advisory opinions, was asked by the Legislature to review the constitutionality of the proposed Massachusetts Port Authority's enabling act. The court, although it declared the bill constitutional, declared that:

> "the features of [the bill] purporting to grant exclusive privileges as long as any bonds are outstanding would be subject to revocation and amendment by succeeding legislatures.
>
> "The power of revocation is not, however, without limits." 136 N.E.2d 232-233.

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50. Appellant emphasizes that in its 1963 report, the Farley Committee characterized the 1962 covenant as "constitutionally protected." A.B. 12, 18, 75. But that characterization provides an analytic starting point, not an end to the case. All contracts are constitutionally protected; it is the scope of the constitutional protection that appellant fundamentally misunderstands.

Appellant chose the bonds of this Authority, bonds that clearly could be affected by subsequent legislation, as the standard for comparison with the bonds of the Port Authority of New York and New Jersey.

Thus, the covenant was always vulnerable to an exercise of the police power and its vulnerability was apparent from the moment the covenant was conceived. And appellant's chief witness testified that he was aware at all relevant times that under certain circumstances a State may constitutionally abrogate its contracts, and that other pledges had been repudiated. A 950-951, 952.

Appellant's claim that bondholders relied on the covenant is untenable.[51] Even if the Court were disposed to give no weight to the fact that testimony concerning reliance is inevitably self-serving, the claim of reliance is circular in this context. What was allegedly relied on was the continuation of a statute known to be vulnerable to future change if circumstances warranted. When such circumstances eventuate, a claim of reliance obviously cannot block a responsive change. Appellant cannot escape the trial court's holding that:

> "Those who enter into contractual relations with the sovereign, including the bondholders of the Port Authority, are chargeable with the knowledge that it is a sovereign entity with which they are dealing and

51. Although the trial court found that bondholders had relied on the covenant in the sense that it "in some manner furnished security for the bondholders and it protected the diversion of the earnings of the Port Authority into deficit rail mass transit," A 110, he noted that few if any members of the investment community ever analyzed closely the actual effect it had on bondholder security. A 108. Moreover, appellant's chief witness understood neither the covenant, nor the other provisions of the Port Authority resolutions. What was relied on was not specifics but a vague sense that the covenant was necessary, as Mr. Thompson mistakenly put it, to prevent "the possibility of massive deficit operations getting into the Port structure" and "that if the Port Authority were given a white elephant that all of the revenues of the Port operations, operating revenue, would be pooled in order to support that before debt service would be paid." See p. 35 *supra*.

that 'the reservation of [the] essential attributes of sovereign power' is as much a part of their contract as that which is expressly stated." A 128.[52]

C. Though Municipal Bonds Are Subject to the Police Power, They Are Readily Marketable.

Although the precedents holding all contracts, including those of the State, subject to the police power are indelibly clear, see pp. 65-75, *supra,* appellant, and *amicus* S.I.A. even more hysterically, claim that the consequences of applying this rule will be catastrophic. See, *e.g.,* Amicus Brief 4: "A holding that the repeal legislation is valid would severely limit, if not foreclose, the access of municipal borrowers to the capital market. . . ." The claim is overwhelmingly refuted by the record.[53]

The heart of appellant's contention is the assertion that the municipal bond market could not function if promises underlying bonds are subject to the reasonable exercise of the police power. The short answer is that it has always functioned this way.

The Massachusetts Port Authority experience is telling because it was appellant, not the State, who chose that agency's bonds as a high-quality municipal credit to be used as a standard for comparison. The Massachusetts Port Authority was born with an express judicial declara-

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52. In the passage from *Kheel* v. *Port of N.Y. Auth.,* 331 F. Supp. 118, 122 (S.D.N.Y. 1971), *aff'd on other grounds,* 457 F.2d 46 (2d Cir.), *cert. denied,* 409 U.S. 983 (1972), immediately preceding the excerpt quoted at A. B. 14 n.11, Amicus Brief 20, Judge Tyler said that the contention that the covenant's "delegation to the bondholders is irrevocable [is] a highly questionable one, see *Home Bldg. & Loan Assn.* v. *Blaisdell,* 290 U.S. 398, 427-439 (1934), *Trustees of Dartmouth College* v. *Woodward,* 4 Wheat. 518, at 712 (concurring opinion of Justice Story (1819))."

53. The Amicus Brief nowhere claims objective damage to bondholders. Its many quotations merely assert that some people were offended by the States' exercise of their police power. *Amicus'* selective quotations from the Moreland Act Commission Report, pp. 14-16, are misleading as the Commission concluded: "[T]he inferences that may be drawn from the 1974 repealer are far from clear. UDC officials have argued that the repealer closed the bond market

(Footnote continued)

tion that the provisions in its enabling act could be altered by subsequent legislation. See *Opinion of the Justices,* p. 75, *supra.*

On two subsequent occasions this reserved power was used and its use sustained over the objection that the changes would disadvantage bondholders. In *Massachusetts Port Authority* v. *Treasurer & Receiver General,* 352 Mass. 755, 227 N.E.2d 902 (1967), the issue was whether it was constitutional to increase the Authority's liability for retirement benefits payable to employees of a project put under Authority management. The court held it was, relying on the police power doctrine:

> "Unquestionably the increase in the prior creditable service of former Mystic employees by the 1960 act will tend to increase to some extent . . . the annual operating expenses of M.P.A. over what they would have been if the 1960 statute had not been enacted. We think, however, that this increase does not effect any substantial or unconstitutional impairment of the security behind M.P.A.'s revenue bonds. The contract underlying these bonds was necessarily made subject to the possibility that subsequent legislation, for proper purposes affecting the public interest, might in some degree affect M.P.A.'s revenues." 227 N.E.2d at 906.

Next, in *Opinion of the Justices,* 313 N.E.2d 882 (Mass., 1974), the court upheld an amendment of the Massachusetts

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(Footnote continued)

to them, yet in September 1974, shortly after the Port Authority covenant had been repealed, UDC was able to sell readily a large issue of moral obligation bonds. HFA too was able to sell moral obligation bonds until 1975. . . ." Report 163.

Amicus relies heavily on a partisan article by a bond attorney and a student. Amicus Brief at 12, 16-17, 19-20. Written before trial, it assumes the validity of the testimony before the Farley Committee that without the covenant the Port Authority "could not sell a single Port Authority bond," 6 *Seton Hall L. Rev.* 48 at 78 (1974), and contains no reference at all to the energy crisis and environmental regulations. The cases discussed in this brief at 74-75, 78-81, 93, show that it is plainly wrong in asserting that "legislative impairment of bondholders' rights because of the economic crisis [*sic*] has been permitted only when any other result would lead to total fiscal collapse of the bond issuer and the impossibility of payment of the bonds." Amicus Brief 20.

Port Authority enabling statute changing the provisions that all property held by the Authority or its lessees was immune from local property taxes. The Court realized that the change might have a "substantial impact on the Authority's revenues." Nonetheless it held that "the essential obligations of the bondholders' contract, i.e., that the Authority make timely payment of the interest on and principal of the bonds would be unaffected." 313 N.E.2d at 887.

Despite this history of change and continuing vulnerability to change, Massachusetts Port Authority bonds are held in high regard by the investment community.

The reactions of Moody's, Standard and Poor's, and Barr Brothers to repeal, see pp. 37-40, *supra,* leave no doubt that the bonds of the Port Authority of New York and New Jersey also continue to be an attractive investment though, like all contracts, they remain subject to the State's police power.

Nor is this surprising. The Constitution and the courts assure that the police power will not be exercised capriciously. Affirmance here does not mean that the States can do anything they choose. While this Court has had few contract clause cases in recent years, the impairment prohibition has been invoked more frequently in the State and lower federal courts. They have found adequate guidelines in *Blaisdell* and *El Paso* for weighing State interests against private expectations. In fact, the courts of New Jersey and New York have each rejected legislation having the most trivial impact on bondholders precisely because no paramount State interests were involved. *New Jersey Highway Auth.* v. *Sills,* 111 N.J. Super. 313 (Ch. Div. 1970), *aff'd,* 58 N.J. 432 (1971), invalidated legislation that entitled members of the National Guard going to or from duty to drive on the New Jersey Turnpike toll free. A clearer example of *de minimis* effect on bondholders can hardly be imagined. It was still deemed improper under the contract clause. *Patterson* v. *Carey,* App. Div.2d , 383 N.Y.S.2d

414 (3d Dep't 1976), struck down legislation mandating a rollback of a toll increase for lack of a sufficient police power justification.

The continuing need of States for borrowed capital imposes additional constraints upon State legislation threatening a State's own or its agencies' obligations. Appellant's and *amicus'* theory—that the State can be trusted to maintain a benevolent neutrality when mediating conflicting private interests, but is surely greedy when dealing with its own—has the political truth backwards. In many private disputes, one side has far more political power than the other: there are, for example, many more tenants than landlords. And that political power has been known to affect legislative impartiality. But the heavy balance of pressure is the other way when the State wishes to borrow money. Nobody has to lend to the State; and yet its affairs cannot be managed unless many do. As a consequence, investors and their representatives have enormous political influence. *Amicus'* members have sold billions of dollars of so-called moral obligation bonds, bonds which are not even legally binding obligations of the States, only because they, and investors, realize this underlying reality.

In *N. J. Sports & Exposition Auth.* v. *McCrane,* 61 N.J. 1, *appeal dismissed,* 409 U.S. 943 (1972), the court upheld the constitutionality of the legislation establishing the Sports Authority. In separate opinions, Chief Justice Weintraub and two of his colleagues expressly stated that the State could abolish or curtail horse racing, though revenues from that activity were the Authority's primary means of paying its bonds. 61 N.J. at 37-39, 58. The four-member majority of the court believed the question "hypothetical" and not properly before the court. 61 N.J. at 28. The majority agreed, however, that bond covenants were subject to "a proper exercise of the State's never abdicated police powers." 61 N.J. at 26. If the protestations of appellant and *amicus* had any substance, the Sports Authority bonds should not have been marketable. Yet the

bonds were sold in January 1974, just as the Port Authority's 42nd series was sold after the decisions below, A 1123-1124.

The bond market does not need unique immunity from the police power. To confer it would be to grant sophisticated investors seeking a tax-free return a certitude in arranging their affairs denied to everyone else.

D. The 1974 Repeal Legislation Constituted an Exercise of the States' Police Power.

The repeal of the covenant was obviously an exercise of the police power of the States. As shown in the Counter-Statement of the Case, pp. 56-59, *supra,* repeal had been considered on three prior occasions in the immediate past. It moved forward swiftly in 1974 because of an energy crisis that was an everyday reality to anyone who needed gasoline for an automobile. Federal orders that would restrict use of automobiles to reduce pollution hung over the State. Even appellant's chief witness, in a letter written to *The New York Times* the day after Governor Bryne signed the repeal, characterized government efforts to improve mass transit as a proper use of State police power. A 246.

Thus, appellant's assertion that the crises in mass transit, energy and pollution were just a matter of coincidence is unfounded.

Appellant's complaint comes down to the proposition that the 1974 law contained no findings of fact or declarations of emergency. Yet no authority of this Court holds that such findings or declarations are constitutionally required. In *Home Building & Loan Ass'n* v. *Blaisdell,* 290 U.S. 398 (1934), the Minnesota Supreme Court had supplemented the legislative findings with its own findings concerning economic conditions in the State, noting that "Courts must be guided by what is common knowledge." See 290 U.S. at 422-423. Chief Justice Hughes' opinion relied upon the Minnesota Attorney General's oral argument expounding the conditions that had prompted the mortgage moratorium.

Similarly, in *El Paso* v. *Simmons,* 379 U.S. 497 (1965), this Court relied on books and land office records in describing Texas' experience with its land policy, and the record was silent as to what, if anything, had been said in the legislature. See also *Butchers Union Co.* v. *Crescent City Co., supra,* 111 U.S. 746 (1884).

The courts below properly declined to declare that the Constitution requires the Legislature to garnish its enactments with ritual recitals of what everyone knows and appellant concedes—that improving mass transit is responsive to vital energy and environmental needs. New Jersey too follows the rule that the "courts must be guided by what is common knowledge." *Bucsi* v. *Longworth Building & Loan Ass'n,* 119 N.J.L. 120, 122 (E. & A. 1937), *appeal dismissed,* 305 U.S. 665 (1938).

This Court's precedents also reject the contention that use of the police power must be based on emergencies or declarations thereof. In *Gelfert* v. *National City Bank,* 313 U.S. 221 (1941), the Court reviewed the constitutionality under the contract clause of a New York statute that drastically diminished the protection enjoyed by mortgagees. Under the statutes applicable when the mortgage was made, the mortgagee was entitled to a deficiency judgment for the short-fall between the price received for the property and the amount owed. The new statute authorized a court to set a "fair and reasonable value on the property" different from that for which it in fact sold.

The challenged statute, Chapter 510 of the Laws of New York, 1938, included neither legislative findings nor a declaration of emergency. The New York Court of Appeals held it unconstitutional because it was "not addressed to a declared public emergency," and was "not designed for the relief of urgent public needs," 313 U.S. at 230. Despite this deprecating characterization by the highest State court concerning the product of its own Legislature, this Court reversed the decision, holding:

> "The fact that an emergency was not declared to exist when this statute was passed does not bring within the protective scope of the contract clause rights which were denied such protection in *Honeyman* v. *Jacobs*." 313 U.S. at 235.[54]

Veix v. *Sixth Ward Building & Loan Ass'n of Newark*, 310 U.S. 32 (1940), also rejected the argument that a declared emergency is necessary to legislative action under the police power. The statute under attack in *Veix* permanently modified the contractual right of depositors to withdraw their money from savings and loan associations; the statute contained no declaration of emergency. After stating that "all contracts are made subject to the [State's] paramount authority," 310 U.S. at 38, the Court responded to appellant's contention that *Blaisdell* was limited to emergency legislation of a temporary character:

> "The cases [including *Blaisdell*] cited in the preceding paragraph make repeated reference to the emergency existing at the time of enactment of the questioned statutes. Many of the enactments were temporary in character. We are here considering a permanent piece of legislation. So far as the contract clause is concerned, is this significant? We think not." 310 U.S. at 39.[55]

E. Repeal Constituted a Reasonable Exercise of the States' Police Power.

1. *The Blaisdell case*

Home Building & Loan Ass'n v. *Blaisdell*, 290 U.S. 398 (1934), is the starting point of modern contract clause

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54. *Gelfert* totally repudiates appellant's arguments, A.B. 63-64, that the decision in this case should turn on whether the repeal is temporary or long-lasting—a distinction appellant urges on the ground that *Bronson* v. *Kinzie*, 42 U.S. (1 How.) 311 (1843), is controlling. *Gelfert* effectively overruled *Bronson*, noting it had by *Blaisdell*, "been confined to the special circumstances there involved . . . . We cannot permit the broad language those early decisions employed to force legislatures to be blind to the lessons which another century has taught." 313 U.S. at 235.

55. If the existence of an emergency were significant, New Jersey's energy crisis and public health problems would clearly qualify.

analysis. As the Court observed in *East New York Savings Bank* v. *Hahn,* 326 U.S. 230, 231-232 (1945):

> "The comprehensive opinion of Mr. Chief Justice Hughes in that case cut beneath the skin of words to the core of meaning. After a full review of the whole course of decisions expounding the Contract Clause—covering almost the life of this Court—the Chief Justice, drawing on the early insight of Mr. Justice Johnson in *Ogden* v. *Saunders,* 12 Wheat. 213, 286, as reinforced by later decisions cast in more modern terms, e.g., *Manigault* v. *Springs,* 199 U.S. 473, 480; *Marcus Brown Co.* v. *Feldman,* 256 U.S. 170, 198, put the Clause in its proper perspective in our constitutional framework."

Blaisdell declared that the validity of a contract modification turns on "whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end," 290 U.S. at 438, repeated in *El Paso* v. *Simmons,* 379 U.S. 497, 507 n.9 (1965). The search is for "a rational compromise between individual rights and public welfare." 290 U.S. at 442.

The central question asks whether a valid public interest is being served. Thus, legislation may not simply extinguish contract rights because it is inconvenient to pay them. *Lynch* v. *United States,* 292 U.S. 571 (1934). *Compare Veix* v. *Sixth Ward Building & Loan Ass'n of Newark, supra,* (public interest, law upheld), *with Treigle* v. *Acme Homestead Ass'n,* 297 U.S. 189 (1936) (similar law, but found to have been "directed merely toward a private right and not deemed in the public interest." 310 U.S. at 41). *Cf. New Jersey Highway Auth.* v. *Sills,* 111 N.J. Super. 313, 320 (Ch. Div. 1970), *aff'd,* 58 N.J. 432 (1971) (law invalid where primary objective "conferring of personal benefit upon Guardsmen and reservists" rather than "any

problem of state-wide importance" as in *El Paso*). In addition, the legislation must not reveal a "studied indifference" to the interests of persons seeking to enforce contractual obligations. *W. B. Worthen Co.* v. *Kavanaugh,* 295 U.S. 56 (1935).

While appellant tries at length to read error into the trial court's discussion of *Worthen* v. *Kavanaugh, supra,* A.B. 58-59, that court's treatment is perfectly consistent with this Court's analysis in *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502, 515 (1942), where the Court inquired whether the legislature had been guilty of "studied indifference" to private interests.

Thus, contrary to appellant's analysis, *El Paso* v. *Simmons,* which provides the most recent expression of the standards controlling this case, did not set forth contract clause principles applicable only to the most aberrant of settings. It was part and parcel of a continuing search for a fair accommodation between two principles that frequently clash—contract rights are constitutionally entitled to respect, and the States must retain their sovereign power to protect their people.

2. *The El Paso case*

Texas provided for the sale of public lands on very easy credit terms when it was raising money for school funds and seeking to encourage settlement. The statutes governing these sales provided that one who forfeited the land back to the State for non-payment of interest had an unlimited time in which to reinstate his rights by payment of back interest, subject to the vesting of rights in third persons. In 1941, after a history of land title disputes and rampant speculation in such lands, Texas limited the right of reinstatement to five years. Simmons was the owner of a deed to land contracted for in 1910, for which the

timely payment of back interest had not been made. He challenged the constitutionality of the 1941 law after Texas transferred the property to the City of El Paso in 1957.

Despite the dissent of Justice Black, who urged retention of formal categories of impairment analysis in preference to standards of reasonablness, all the other Justices took the contrary view. The Court held squarely that "it is not every modification of a contractual promise that impairs the obligation of contract under federal law." 379 U.S. at 506-507. Quoting extensively from Chief Justice Hughes' opinion in *Home Building & Loan Ass'n* v. *Blaisdell, supra,* Justice White wrote this key passage, 379 U.S. at 508-509:

> "The decisions 'put it beyond question that the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula,' as Chief Justice Hughes said in *Home Building & Loan Assn.* v. *Blaisdell,* 290 U.S. 398. The Blaisdell opinion, which amounted to a comprehensive restatement of the principles underlying the application of the Contract Clause, makes it quite clear that '[n]ot only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end "has the result of modifying or abrogating contracts already in effect." *Stephenson* v. *Binford,* 287 U.S. 251, 276. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. . . . This principle of harmonizing the constitutional prohibition with the necessary residuum of state power has had progressive recognition in the decisions of this Court.' 290 U.S. at 434. Moreover, the

'economic interests of the state may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts.' *Id.*, 290 U.S. at 437. The State has the 'sovereign right . . . to protect the . . . general welfare of the people. . . . Once we are in this domain of the reserve power of a State we must respect the "wide discretion on the part of the legislature in determining what is and what is not necessary." ' *East New York Savings Bank* v. *Hahn,* 326 U.S. 230, 232-233. As Mr. Justice Johnson said in *Ogden* v. *Saunders,* '[i]t is the motive, the policy, the object, that must characterize the legislative act, to affect it with the imputation of violating the obligation of contracts.' 12 Wheat. 213, 6 L.Ed. 606, 633.

"Of course, the power of a state to modify or affect the obligation of contract is not without limit. '[W]hatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them.' *Blaisdell, supra,* 290 U.S. at 439."

As the last sentence quoted makes clear, the State may not have a policy of repudiating debts, destroying contracts or denying the means to enforce them. In specific instances, however, it may modify contracts where the end is legitimate and the measures taken are reasonable. And in determining whether the measures are reasonable, the legislature has "wide discretion."

The Court proceeded to apply these principles, revealing once again that a considerable loss may constitutionally be inflicted on a party contracting with the State, in further-

ance of governmental ends far less important than those New Jersey was serving here. The Court decided that the Texas law modifying plaintiff's contract served a "vital interest" by promising to disentagle some land titles. 379 U.S. at 515. Obviously, neglect of this interest would not have led to governmental collapse.

The contractual interest impaired, the Court said, was not the seller's "central undertaking" nor the "primary consideration" for the purchaser's undertaking, nor was it the "substantial inducement" to enter the contract. 379 U.S. at 514. This was not, of course, to say that the contractual interest impaired was trivial—its loss cost Simmons title to land he could have owned if the contract were carried out. Though not the "substantial inducement," Simmons' interest was plainly substantial, as indeed were the interests of other parties that have alleged contract impairment, such as people denied money then owed to them. *E.g., Albigese* v. *City of Jersey City,* 127 N.J. Super. 101, 112-113 (Law Div.), *aff'd,* 129 N.J. Super. 567 (App. Div. 1974); *California Teachers Ass'n* v. *Newport Mesa Unified School District,* 333 F. Supp. 436 (C.D. Cal. 1971); *Michigan Transp. Co.* v. *Secretary of State,* 41 Mich. App. 654, 201 N.W. 2d 83 (1972), *leave to appeal denied,* 389 Mich. 767 (1973). Unlike appellant, which has suffered no loss at all, those litigants were seriously damaged.[56]

56. Appellant attempts to sever *El Paso* from its legal background by isolating a series of factors. A.B. 70-78. One searches *El Paso* in vain for any indication that the eight Justices who joined that opinion regarded it as a "narrow exception," A.B. 70, carved out of otherwise firm rules. Nonetheless, appellant reads *El Paso* not as a broad exposition of the police power doctrine but rather as having erected a series of barriers to State action. The approach is wrong. As was indicated above, the applicable principle is that a State may modify a contract when "the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end." The factors emphasized by appellant were the elements present in that particular case that made it reasonable for the State to take Simmons' land without paying.

(*Footnote continued*)

3. *Appellant's claim that the price purchasers were willing to pay for bonds was affected by the covenant is unsupported by the record and immaterial as a matter of law.*

Appellant places great weight on its claim that, supposedly unlike *El Paso,* purchasers were so interested in the covenant that it affected the price they were willing to pay for bonds. The claim is defective in two respects: the record does not support the factual premise on which it rests; and, even if it did, the claim is immaterial as a matter of law.

The weight of the evidence is overwhelmingly against the proposition that the covenant and its repeal ever affected bond prices or interest rates, save for the short-term fall-off to be discussed presently. The record shows that Port

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(*Footnote continued*)

In any event, appellant's distinctions are ill-taken. First, *El Paso* does not say that the five-year limit was the only way to solve the problem; the State could have taken the contingent interest by eminent domain. The Court merely indicated at the pages cited, 379 U.S. at 512-513, that less drastic measures had proved unworkable, precisely the situation here where efforts begun in 1970 to involve the Port Authority in expanded rail mass transit had been stymied. Second, the covenant was not a primary inducement to purchase of Authority bonds; the trial court found few if any investors knew what it did. By contrast, in *El Paso,* it was precisely because purchasers knew of and relied upon the reinstatment possibility that land prices soared. Third, appellant says that buyers could not have relied too heavily on reinstatement in *El Paso* because the right was defeasible, though not in the way the State sought to defeat it. Here, too, the covenant provides no security that cannot be taken away because, among other things, it leaves the States free to assign a whole range of deficit-generating activities—*e.g.,* habor waste disposal —to the Port Authority. Fourth, as the trial court found, there have been substantial changes since 1962, both in the Authority's financial picture and in the impact of the energy and environmental crises. Fifth, the covenant does impose a difficult burden upon the State. The reasonableness of its repeal is enhanced because, unlike *El Paso,* where buyers were advantaged by reinstatement, bond investors are not advantaged by the covenant and not harmed by repeal. In fact, their security has been enhanced by increasing the flow of funds against which they have a first lien.

Authority bond prices and interest rates were unaffected in January 1962, even though a rail mass transit law was on the books in one State and related legislation was pending in the other. See page 41, *supra*. In 1972, New York repealed the covenant, an action that is not claimed to have affected bond prices.

The 1973 prospective repeal of the Covenant is likewise not claimed to have had any effect on Port Authority bond prices. Here appellant's explanation is that purchasers —faced with an official statement that the covenant did not apply—were confident that the covenant would nonetheless be continued until 2007. A.B. 24-25. This claim is inconsistent with appellant's assertion, *e.g.*, A.B. 14, that further mass transit could be accomplished by a compromise with holders of covenant-protected bonds.

Next, bond prices were unaffected by the pendency of repeal legislation in both States in 1974. A 210-211, 213-214. Appellant offers no explanation for this.

Finally, since repeal in 1974, the prices at which Port Authority bonds trade in the secondary market have not been affected, save for a short-term decline from which the bonds recovered long ago. At points, appellant seems to argue that this short-term drop is to be treated as the damage its case otherwise so desperately lacks. However, for those who sold during the fall-off, A.B. 40n. 24, invalidation of repeal would do no good; and for those who held on, there is no damage. Moreover, if there was damage, appellant caused it: on the very day New Jersey repealed the covenant, appellant held a news conference in which it announced the filing of this suit, characterized the repeal of the covenant as a severe blow to bondholders, and declared that it would no longer buy Port Authority bonds. See A 44-45. The wire services carried the story. This was the trustee and largest holder of Port Authority bonds