a unified project, the said interurban electric railway and its extensions and the [World Trade Center] * * * [*N. J. S. A.* 32:1–35.50]

The operative provisions of the covenant are contained in the first paragraph of § 6 of *chapter* 8, *N. J. S. A.* 32:1–35.55, and they are as follows:

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, (a) the 2 States will not diminish or impair the power of the port authority (or any subsidiary corporation incorporated for any of the purposes of this act) to establish, levy and collect rentals, tolls, fares, fees or other charges in connection with any facility constituting a portion of the port development project or any other facility owned or operated by the port authority of which the revenues have been or shall be pledged in whole or in part as security for such bonds (directly or indirectly, or through the medium of the general reserve fund or otherwise), or to determine the quantity, quality, frequency or nature of the service provided in connection with each such facility; and (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.

"Affected bonds" are defined as including all bonds secured in whole or in part by the general reserve fund or any other reserve fund established by contract between the Authority and the holders of its bonds. Since all consolidated bonds are secured by a pledge of the general reserve fund, as well as the consolidated bond reserve fund, all outstanding consolidated bonds, with the exception of those of the 40th and 41st series,[25] are affected bonds under the terms of the covenant.

"Permitted purposes" as defined in the statute include: (1) the H&M as it existed on the effective date of the legislation;

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[25]See *infra* at 179–180.

(2) any railroad freight facilities owned by the Authority; (3) railroad tracks on vehicular bridges owned by the Autority; and (4) passenger railroad facilities (other than the H&M) only if one of two conditions is met: (i) the Authority certifies that such other railroad facility is self-supporting, or (ii) if the general reserve fund contains the required statutory amount (10% of all outstanding Authority bonds) and the Authority certifies that the deficit of such other facility, together with the deficits of all other passenger railroad facilities owned by the Authority, will not exceed "permitted deficits" as thereafter defined.

A passenger railroad facility may be certified as "self-supporting" if its estimated average annual net operating income for the first ten years of operations is at least equal to the estimated average annual debt service on bonds issued in connection with the facility.

A passenger railroad "deficit" is defined as the average estimated annual debt service upon the bonds issued for passenger railroad purposes over the first ten-year period of operations less the average estimated annual net operating income of the railroad facility, or plus the average estimated annual net loss of the railroad facility. To illustrate: If the average annual debt service requirement is $10,000,000 and the average annual net operating income is $5,000,000, the statutory deficit is $5,000,000. If it is estimated that an average annual net loss of $5,000,000 will be incurred from operations, the statutory deficit would be $15,000,000.

A "permitted deficit" is a deficit which does not exceed (A) the amount of the passenger railroad deficit the payment of which one or both states is willing to guarantee for the period for which the Authority would be liable for such deficit, plus (B) the greater of (1) an amount equal to 10% of the general reserve fund at the end of the preceding calendar year less an amount equal to 1% of the Authority's bonds outstanding at the end of the preceding calendar year which were issued for passenger rail purposes (including the H&M), or (2) an amount equal to 10% of the amount

calculated under clause (1) plus 1% of the Authority's equity in all facilities other than passenger rail facilities.

Thus, assuming the States of New York and New Jersey enter into an agreement with the Authority to pay the deficit of a proposed passenger railroad facility, the deficit of such facility is a permitted deficit under the 1962 covenant and the Authority is authorized to issue its bonds for such purpose. In the absence of a guarantee by the states to pay any part of the deficit, the maximum permitted deficit must be calculated under (B) as reflected in the following illustration: Assuming the general reserve fund contains $175,000,000 and the Authority has outstanding bonds issued for the H&M and other passenger railroad purposes in the amount of $150,000,000, clause (1) permits the Authority to issue bonds secured by the general reserve fund if the estimated average annual deficits of all its passenger rail facilities, including the proposed facility, do not exceed $16,000,000 ($17,500,000 – $1,500,000). Assuming the same facts and an Authority equity in nonrailroad facilities of $1,200,000,000, under clause (2) the permitted deficit would be $13,600,000 ($1,600,000 + $12,000,000). Hence, on the assumed facts, since the amount calculated under clause (1) is greater, the permitted deficit would be $16,000,000[26].

On September 1, 1962, following enactment of the 1962 covenant legislation referred to above, the Port Authority, through a wholly-owned subsidiary (Port Authority Trans-Hudson Corporation or PATH), assumed ownership and operating responsibilities over the H&M. The Commissioners' 1962 certification with respect to the acquisition of the PATH System was made on the basis of an opinion of A. Gerdes Kuhbach, the Director of Finance of the Port Authority,

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[26]Since the annual deficits of the H&M (operated by the Authority under the acronym PATH) are substantially in excess of the permitted deficits calculated under 1963 covenant formula, the covenant prohibits the Authority from issuing any bonds for passenger rail purposes which would be secured by a pledge of the reserve funds of the Authority. See *infra* at 165.

which was prepared at the request of the Commissioners. His opinion analyzed and reviewed the financial aspects and data relating to the proposed acquisition, rehabilitation and operation of the PATH system. He concluded that the section 7 certification required under the series consolidated bond resolutions could be made, since the anticipated net loss after debt service for the years 1969 through 1991 would level off at approximately $6,595,000[27] per year, an amount that would not impair the sound credit rating of the Port Authority. More specifically, Kubach concluded that

> a) There is always a comfortable margin between the anticipated net loss and 10% of the estimated General Reserve Fund;
>
> b) Net revenues available for Reserves will not be materially diluted by undertaking the acquisition, rehabilitation and operation of the Hudson Tubes:
>
> c) The coverage of both annual obligatory long term debt service and future maximum debt service is sufficiently within the limits necessary to preserve the Port Authority's credit and to continue the issuance of Consolidated Bonds.
>
> I therefore conclude that the application of all or any portion of unexpended proceeds of Consolidated Bonds, Nineteenth Series, Due 1991, will not during the years 1962 through 1991, in light of the estimated expenditures in connection with the Hudson Tubes, materially impair the sound credit standing of the Authority or the investment status of the Consolidated Bonds or the ability of the Port Authority to fulfill its commitments, whether statutory or contractual or reasonably incidental thereto, including its undertakings to the holders of Consolidated Bonds.

Since the enactment of the 1962 covenant the Port Authority has referred to the covenant in all official statements furnished to the public in connection with each series of consolidated bonds issued by the Authority. The reference is set forth under the heading "Statutory Covenant With Prior Affected Bondholders Against Dilution of Pledged Revenues and Reserves by Additional Passenger Railroad Deficits," and the terms of the covenant are then summarized. The first two sentences of text read as follows:

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[27] In 1962 the general reserve fund was approximately $69 million.

In connection with the legislation which authorized the Port Authority to assume responsibility for the Hudson Tubes system the Port Authority had advised the Legislatures of both States that the credit of the Port Authority would be impaired by such an undertaking of an anticipated perpetual deficit facility unless the States would enter into an enforceable contract with the Port Authority bondholders which would grant assurances against dilution of already pledged revenues and reserves by any additional passenger rail deficits beyond those of the basic Hudson Tubes System. The legislation as finally adopted includes such statutory covenants.

As of December 31, 1973 the Authority had invested $185,800,000 of its funds in the acquisition and improvement of PATH. The accumulated operating deficits of PATH (determined in accordance with ICC accounting practices) total $125,000,000,[28] of which approximately $17,000,000 constitutes depreciation. PATH has incurred an annual deficit after debt service for each of the last five years in excess of 10% of the general reserve fund. Accordingly, under the 1962 covenant the Port Authority would be precluded from pledging any of its revenues or reserves to any other deficit passenger railroad operation. In 1973, using the Authority's accounting procedures, the PATH deficit for the year, including debt service, was $24,913,000.

Following the enactment of the 1962 covenant legislation an action was instituted in the New York state courts challenging the validity of the statute by New York property owners. The principal issues presented in the action dealt with the legislative authorization to the Authority to construct the World Trade Center. The plaintiffs urged, among other things, that the legislation was unconstitutional because no congressional consent had been obtained. The New York Court of Appeals upheld the constitutionality of the covenant legislation, and the appeal therefrom was dismissed by the United States Supreme Court for want of a substantial fed-

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[28]Using the Authority's method of accounting, the accumulated PATH deficit as of December 31, 1973 was $153,073,000, inclusive of debt service.

eral question. *Courtesy Sandwich Shop v. Port of N. Y. Auth.*, 12 *N. Y.* 2d 379, 240 *N. Y. S.* 2d 1, 190 N. E. 2d 402, app. dism. 375 *U. S.* 78, 84 S. Ct. 194, 11 L. Ed. 2d 141, *reh. den.* 375 *U. S.* 960, 84 S. Ct. 440, 11 L. Ed. 2d 318 (1963). The Court of Appeals disposed of the consent argument in the following manner:

> This argument must fail because, assuming consent to be required for this sort of concurrent action, the congressional consent originally given in 1921 and 1922 to the bi-State compact creating the Port Authority expressly contemplated such further co-operative legislation in furtherance of port purposes as was here accomplished. * * * Among the Articles of Agreement consented to were articles III, VII and VI, which created the Port Authority with the powers enumerated plus "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." Similarly, article XI, following the agreement for an initial comprehensive plan in article X, provides that the Port Authority should "from time to time make plans for the development of said district, supplementary to or amendatory of any plan theretofore adopted, and when such plans are duly approved by the legislatures of the two States, they shall be binding upon both States with the same force and effect as if incorporated in this agreement." Chapter 209 clearly falls within the congressional consent given to the articles contemplating the grant to the Port Authority of additional powers within the framework of the compact. [12 *N. Y.* 2d at 391, 240 *N. Y. S.* 2d at 7, 190 N. E. 2d at 406]

The lack of congressional consent to the covenant legislation was also raised by Port Authority bondholders in *Port Authority Bondholders Pro. Com. v. Port of N. Y. Auth.*, 387 *F.* 2d 259 (2 Cir. 1967). The Court of Appeals affirmed the dismissal of the bondholders complaint, having concluded that the United States Supreme Court's disposition in *Courtesy Sandwich Shop* had labeled the question "as unsubstantial." 387 *F.* 2d at 262.

In 1971 Theodore Kheel, Esq., and others instituted a class action in the United States District Court for the Southern District of New York challenging the constitutionality of the 1962 covenant on the grounds that it restricted the Authority's power to devote its revenues to nonself-supporting passenger rail facilities, in violation of the Compact and

Commerce Clauses of the United States Constitution, and impaired legislative sovereignty. The District Court dismissed the complaint, relying in part upon the disposition made in *Courtesy Sandwich Shop. Kheel v. Port of N. Y. Auth.*, 331 *F. Supp.* 118 (S. D. N. Y. 1971), aff'd on other grounds, 457 *F.* 2d 46 (2 Cir. 1972), *cert. den.* 409 *U. S.* 983, 93 S. Ct. 324, 34 L. Ed. 2d 248 (1973).

Legislative History of the Repeal of the 1962 Covenant.

Despite the enactment of the 1962 covenant, during the latter part of the 1960's and continuing to date there has been increasing public and governmental demand for the Port Authority to make a greater contribution toward a solution of the mass transit problems within the Port District. The critics of the Port Authority, as well as responsible executive and legislative officials, have focused primarily upon the utilization of the surplus earning capacity of the Authority's existing facilities to finance further Authority acquisition of or direct subsidies to mass transit facilities. It may be noted that between 1961 and 1970 the net revenues of the Authority had increased from $68,000,000 to $115,000,000, and over that period the Authority had available to it $454,000,000 in funds in excess of its debt service requirements.

In July 1964 Congress enacted the Urban Mass Transportation Act of 1964 (49 *U. S. C. A.* §§ 1601 *et seq.*), expressing for the first time a federal legislative interest in the support of urban mass transportation systems. In enacting the 1964 act Congress found (49 *U. S. C. A.* § 1601(a)):

> **(1) that the predominant part of the Nation's population is located in its rapidly expanding metropolitan and other urban areas, which generally cross the boundary lines of local jurisdictions and often extend into two or more States;**
>
> **(2) that the welfare and vitality of urban areas, the satisfactory movement of people and goods within such areas, and the effectiveness of housing, urban renewal, highway, and other federally aided programs are being jeopardized by the deterioration or inadequate**

provision of urban transportation facilities and services, the intensification of traffic congestion, and the lack of coordinated transportation and other development planning on a comprehensive and continuing basis; and

(3) the Federal financial assistance for the development of efficient and coordinated mass transportation systems is essential to the solution of these urban problems.

The purposes of the 1964 act were declared to be (49 *U. S. C. A.* § 1601(b)):

(1) to assist in the development of improved mass transportation facilities, equipment, techniques, and methods, with the cooperation of mass transportation companies both public and private;

(2) to encourage the planning and establishment of areawide urban mass transportation systems needed for economic and desirable urban development, with the cooperation of mass transportation companies both public and private; and

(3) to provide assistance to State and local governments and their instrumentalities in financing such systems, to be operated by public or private mass transportation companies as determined by local needs.

The scope of the 1964 act was expanded by the Urban Mass Transportation Assistance Act of 1970 on the basis of a finding by Congress (49 *U. S. C. A.* § 1601a) that "the rapid urbanization and the continued dispersal of population and activities within urban areas has made the ability of all citizens to move quickly and at reasonable cost an urgent national problem."[29]

In April 1970 Governors Cahill and Rockefeller announced a joint program to increase the Port Authority's role in mass transportation by building a rail link to John F. Kennedy International Airport and extending PATH to Newark International Airport and other parts of New Jer-

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[29]In November 1974, after the repeal of the 1962 covenant, Congress enacted the National Mass Transportation Assistance Act of 1974, which provided $11.8 billion over the next six years for mass transit capital expenditures and, for the first time, operating subsidies on a matching basis.

sey. Bills were introduced in the New Jersey and New York Legislatures authorizing the Port Authority to undertake mass transportation projects providing access to John F. Kennedy and Newark International Airports. In March 1971 joint hearings were held in New York and New Jersey by the New York State Assembly Committee on Corporations, Authorities and Commissions and by the Autonomous Authorities Study Commission of the New Jersey State Legislature with respect to the relationship of the Port Authority to mass transportation and the proposed passenger rail links to the airports. In June 1971 the Legislatures of New York and New Jersey enacted legislation authorizing the Port Authority to extend passenger rail transportation to Kennedy International Airport and to Newark International Airport and Cranford. *L.* 1971, *c.* 245; *N. J. S. A.* 32: 1–35.20 *et seq.* The sponsors of this legislation sought to avoid the limitations of the 1962 covenant by characterizing the proposed new railroad facilities "as constituting a part of each air terminal" rather than independent passenger railroads. *L.* 1971, *c.* 245, § 1. While this legislation was pending, the Port Authority obtained opinion letters from two New York law firms which concluded that the proposed rail extensions were subject to the provisions of the 1962 covenant and could not be financed out of Port Authority revenues or reserves unless "self-supporting" since PATH had used up all of the "permitted deficits" allowed by the covenant.

Following the enactment of the 1971 legislation the Commissioner of the New Jersey Department of Transportation commissioned a consulting firm to report on the Authority's ability to finance and operate the New Jersey PATH extension under the terms of existing covenants with bondholders, and to propose alternative financing programs if the Authority could not. The consultant's report was submitted in December 1971. At the outset it was noted that on the assumption the proposed additional facilities would operate

at a deficit, the 1962 covenant prohibited Authority financing and operation since the PATH deficit already exceeded the "permitted deficits" allowed by the covenant. The conclusion of the report was that the Port Authority was not, under the 1962 covenant, in a "favorable position" to provide the additional financing necessary for the proposed extensions of existing passenger rail facilities. The consultants recommended as an alternative solution the removal of PATH from the Authority's control so that the latter would no longer be responsible for its deficits.

In June 1972 the Port Authority and New Jersey Department of Transportation concluded on the basis of an engineering cost study that the proposed extension of PATH via Newark Airport to Cranford was not economically feasible under the terms of the 1962 covenant.

In the same month the State of New York passed a bill repealing the 1962 covenant. *Laws of* N. Y. 1972, *c.* 1003. Governor Rockefeller's message on the signing of that legislation stated:

> I am approving this bill in order to give incentive to the Port of New York Authority to proceed with urgently needed mass transportation facilities in the metropolitan region.
>
> Passed with overwhelming bipartisan support in both houses of the Legislature, the bill removes the absolute statutory prohibition against the use of the revenues of the Port of New York Authority for railroad purposes. That statutory covenant, together with the provision of the bi-state compact creating the Authority that neither State will construct competing facilities within the Port District, could forever preclude the two states from undertaking vitally needed mass transportation projects. In removing the present restriction, the bill would not jeopardize the security of Port Authority bondholders or their rights to maintain that security.
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> * * * * * * * *
>
> New York, by the enactment of this measure, is taking an essential step in its long-range effort to realize the full potential of the Port Authority in meeting the total transportation needs of the New York-New Jersey port district. The Port Authority's active participation in helping to solve the problems of mass transportation in the New York City metropolitan area will inure to the benefit not only of millions of area residents generally, but also to the port facilities operated by the Authority and the workers and businesses that rely

on them. This bill is consistent with the original purpose of the Port Authority — to ensure the coordinated development of terminal, transportation and other facilities of commerce in and about the port district for the greater benefit of the people of New York and New Jersey.

The repeal of the 1962 covenant adopted by New York proved to be unacceptable at that time to the New Jersey Legislature and Governor Cahill, and on November 15, 1972, following a series of meetings among Governors Cahill and Rockefeller and the Commissioners of the Port Authority, the Governors announced agreement on a bi-state plan of passenger rail transportation development by the Port Authority. The plan provided for the extension of PATH via Newark Airport to Plainfield, direct rail service from Kennedy Airport to New York City, and direct rail service to Penn Station, New York, for riders of the Erie Lackawanna Railroad in six northern New Jersey counties and two counties in New York. The estimated total cost of the plan was $650,000,000 and it was estimated that the Port Authority would invest between $250,000,000 and $300,000,000, with the balance of the funds being furnished by grants from the Federal Urban Mass Transportation Administration and the states. The Governors also proposed to repeal the 1962 covenant with respect to bonds issued subsequent to the enactment of the legislation proposed by the Governors.

On December 11, 1972 the New Jersey Senate held an information session to consider pending Port Authority mass transit bills. During this session representatives of the Port Authority and of Governor Cahill's office stated that the State of New Jersey would have to commit substantially all of the funds then available to the State of New Jersey from the Federal Urban Mass Transportation Administration.

The legislation embodying the 1962 covenant was amended by the State of New Jersey on December 28, 1972, *L.* 1972, *c.* 208, so as to repeal the 1962 covenant with respect to

Authority bonds issued after the effective date of the legislation. The New York Legislature enacted concurrent legislation which became effective on May 10, 1973. *Laws of N. Y.* 1973, *c.* 318.

On April 22, 1974 the New Jersey Legislature enacted *chapter* 25 of the *Laws of* 1974 (the "repeal act"). Governor Byrne signed the bill on April 30, 1974. Section 1 of this act repealed section 3 of *chapter* 208 of the *Laws of* 1972, the effect of which is to repeal, retroactively, the 1962 covenant as to all issued and outstanding "affected bonds" issued by the Port Authority. The introducer's statement annexed to the Assembly Bill No. 1304 (which became *chapter* 25), sums up the intent and purpose of the action taken:

> This bill is designed to preclude the application of the 1962 covenant restricting port authority participation in mass transit projects. Chapter 208, P. L. 1972, precluded such application to bonds newly issued after the effective date of that act, but maintained in status quo the position of holders of bonds issued between March 27, 1962 and December 28, 1972. Since affected bonds are outstanding until the year 2007, the restrictions imposed by the covenant effectively preclude sufficient port authority participation in the development of a public transportation system in the port district. In 1972 the State of New York passed legislation precluding the application of the 1962 covenant from outstanding bonds as well as newly issued bonds. It is the purpose of this act to accomplish effective repeal of the covenant.

Concurring legislation was signed into law by Governor Wilson of New York on June 15, 1974. *Laws of N. Y., c.* 993. Governor Wilson issued a statement when he signed the bill, in which he said in part:

> In response to my inquiry, the Chairman of the Port Authority has also advised me that because of the heavy long term capital commitments for the PATH facilities and the Kennedy rail link, the Authority has no significant capacity to contribute funds for operating subsidies for commuter railroads. Hence, the plain and simple fact of the matter appears to be that the Authority has virtually no excess funds that could be channeled into operating subsidies for mass transportation facilities in the New York metropolitan area.

Even if such funds were available, existing bond indenture provisions which survive despite repeal of the statutory covenant would prohibit their use except in relation to facilities owned, leased or operated by the Port Authority.

The legislative history of the repeal of the covenant would not be complete without reference to other developments which were of immediate and continuing concern to the states and the nation at or about the time the repeal legislation was enacted. Commencing in the early 1950's and continuing to date the two states initiated studies of air pollution problems in their jurisdictions, and legislative action to control air pollution was undertaken by New Jersey as early as 1954, see *N. J. S. A.* 26:2C–1 *et seq.*, and by New York in 1957, see *Laws of N. Y., c.* 931. In 1955 the United States Congress enacted the Clean Air Act, 42 *U. S. C. A.* § 1857 *et seq.*, the preamble of which sets forth the following findings (among others):

(a) The Congress finds —

(1) that the predominant part of the Nation's population is located in its rapidly expanding metropolitan and other urban areas, which generally cross the boundary lines of local jurisdictions and often extend into two or more States;

(2) that the growth in the amount and complexity of air pollution brought about by urbanization, industrial development, and the increasing use of motor vehicles, has resulted in mounting dangers to public health and welfare, including injury to agricultural crops and livestock, damage to and the deterioration and property, and hazards to air and ground transportation.

(3) that the prevention and control of air pollution at its source is the primary responsibility of States and local governments * * *

The studies which were undertaken identified automobile exhaust emissions as a significant contributing factor in air pollution, and as the primary source of air pollution in the City of New York. In 1962 the State of New York adopted legislation requiring the installation of positive crankcase devices on new cars. *Laws of N. Y.* 1962, *c.* 994. While similar legislation was not enacted in New Jersey, the State did institute on February 1, 1974 an auto emission

testing program as part of the mandatory motor vehicle inspection system.

The efforts of the states to alleviate health hazards associated with air pollution were given a major impetus by the congressional enactment in 1970 of amendments to the federal Clean Air Act, 42 *U. S. C. A.* § 1857(*c–l*) *et seq.*, pursuant to which the Administrator of the federal Environmental Protection Agency was authorized 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.

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 federal Administrator promulgated regulations designed to achieve a major reduction in hydrocarbon and carbon monoxide pollution in the northern part of New Jersey. 38 *Fed. Reg.* 31388 *et seq.* The federally-mandated plan for New Jersey included the mandatory use of retrofit devices on gasoline-powered vehicles and "the application of certain transportation control measures including a requirement for a significant reduction in vehicle miles traveled." 38 *Fed. Reg.* 31389. The Administrator also emphasized the importance of the development of mass transit to the effort to improve 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. The planning, acquisition, and operation of a mass transit system is, and should remain, a regional or State responsibility. 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. * * * [38 *Fed. Reg.* 31389]

Finally, reference must be made to the energy crisis, the dimensions of which became a matter of national concern in the fall of 1973 with the imposition of an oil embargo by

Arabian suppliers of crude oil and the rapid escalation of the price of oil. On February 4, 1974, two months before the repeal legislation was enacted, the New Jersey Legislature passed the Emergency Energy Fair Practices Act of 1974 (*L.* 1974, *cc.* 2, 6).

Section 2 of that act stated:

> **The Legislature finds and determines that because of world conditions and the manner in which energy sources and fuels are allocated and distributed that an energy shortage now exists and may continue for the foreseeable future.**

Section 3 of the act authorized the Governor "to proclaim by Executive Order the existence of an energy emergency" and to establish a State Energy Office and appoint an Administrator with broad powers to control the use and distribution of all fuels. On February 5, 1974 Governor Byrne issued Executive Order No. 1 in which he proclaimed the existence of an energy emergency, created the State Energy Office and established the position of Administrator of that office.

In December 1973 the Regional Plan Association issued a report on the relationship of the energy crisis to transportation. Its findings noted the decline of public mass transit in the metropolitan region and the increased consumption of fuel caused by reliance upon private automobiles to satisfy the major passenger transportation demand of the region. The Association pointed out that

> **If we are serious about meeting a profligate demand for energy over the long pull, we will have to begin now to design a Region that is less energy consumptive in transportation and in its development pattern.**

While the immediate effects of the oil embargo have been dissipated, the nation is still confronted with the long-range effects of oil price increases, particularly as they bear upon the economic well-being of the country. On February

21, 1974 President Nixon described the problem in these terms in a special message to Congress on the energy crisis:

> We must also face the fact that when and if the oil embargo ends, the United States will be faced with a different but no less difficult problem. Foreign oil prices have risen dramatically in recent months. If we were to increase our purchase of foreign oil, there would be a chronic balance of payments outflow which, over time, would create a severe problem in international monetary relations. [*U. S. C. Cong. and Admin. News*, 93rd Cong., 2d Sess. at 36.]

The President further observed, "it is widely recognized now that the development of better mass transit systems may be one of the key solutions to both our energy and environmental problems." *Id.* at 42. Congress has repeatedly made similar findings. For example, the Regional Rail Reorganization Act of 1973, enacted on January 2, 1974, contains specific findings by Congress 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." 45 *U. S. C. A.* §§ 701, 761.

Bondholder Reliance on the 1962 Covenant and the Effects of Repeal.

Commencing with the issuance of the 20th series of 1962 the Authority advised potential investors of the existence of and protection afforded by the 1962 covenant by including detailed reference to the covenant in the official statements distributed to the public. U. S. Trust alleges in its complaint that purchasers of the Authority's consolidated bonds relied on the notice thus given to them in making their purchases. It is also alleged that the repeal of the covenant has diminished and will continue to adversely

affect the value of the bonds in the secondary market.[30] These issues were the subject of a trial at which U. S. Trust produced four witnesses in its behalf, together with numerous exhibits. Defendants relied upon cross-examination of plaintiff's witnesses plus their own exhibits.

Port Authority consolidated bonds are known in the market place as revenue bonds, *i. e.,* they are payable solely from the revenues and reserve funds derived from the facilities operated by the Authority. In the main these bonds are sold to relatively sophisticated institutional investors either for their own accounts or for the accounts of others whose investment funds they manage. Since the bonds carry a fixed rate of return and must compete against other similar types of securities available in the market place, the interest rate fixed when the bonds are initially marketed, as well as the price of the bonds in the secondary market, will normally reflect the investor's evaluation of the underlying security of his investment and the prevailing interest rates available on similar types of securities.

Prior to 1962 the Authority had successfully marketed several hundreds of millions of dollars of its consolidated bonds without the existence of the covenant. Presumably those issues were marketed on the strength of the Authority's overall revenues and reserves as well as in reliance on the previously enacted statutory covenants and the covenants contained in the CBR. The interest rates on these bond issues varied from a low of 2¾% (the 2nd and 4th series) to a high of 4¼% (16th series). The interest rate on the last bond issue offered prior to the enactment of the covenant was 3½% (19th series).

In the early 1960's, prior to the enactment of the 1962 covenant, the likelihood of legislation directing the Authority to take over the H & M became apparent. The record strongly suggests that the Authority itself took the

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[30]The secondary market in this context refers to the over-the-counter price at which the bonds are traded after the initial offering.

initiative in arousing the concern of the investment banking community to the implications of such legislation for the future financial well-being of the Authority. Whether this action was attributable to the Authority's fear of the "disease" of mass transit, see *Goldberg,* at 22, or a legitimate concern as to the Authority's ability to absorb substantial mass transit deficits is not the point; the fact of the matter is that the Legislature of 1962 concluded it was necessary to place a limitation on mass transit deficit operations to be undertaken by the Authority in the future so as to promote continued investor confidence in the Authority.

The fact of the covenant's existence and its terms were communicated to the public and were a matter of general knowledge among investment bankers, institutional investors and dealers in Authority bonds. It may fairly be said, however, that few, if any, members of the investment community ever analysed closely the actual effect of the 1962 covenant upon bondholder security. The principal witness offered by U. S. Trust in support of its contentions, John F. Thompson, whose credentials and qualifications are impeccable, when asked to compare the protections afforded bondholders by the 1962 covenant with the restrictions imposed by the CBR (*i. e.,* the 1.3 test and the section 7 certification required by the bond series' resolutions), testified:

> Well the 1962 covenant and its requirements, require more specific determinations by the commissioners, by the staff and the commissioners as to the earnings or prospects of deficits involved, and they are — well, in the case of the Section 7 requirements, the commissioners can simply rule or state their opinion that the requirement would not harm the holders of the outstanding debt. In the case of the 1.3 times, they are permitted estimates of future earnings to some degree as well as the historical earnings. This is a test which might be complied with on the initiation of a deficit rail facility, and later be found to have not avoided deficits by any means as given the propensity of these deficits to greatly increase.
>
> The determinations which must be made under the covenant, I believe, are much more susceptible to active testing, by those looking at the Port Authority from the outside, and those in the investment community a much more secure feeling about the future profitability of the Port Authority.

Based upon the testimony offered by plaintiff, the investment community's understanding of the covenant was that it in some manner furnished "security for the bondholders and it protected the diversion of the earnings of the Port Authority into deficit mass rail transit." If the covenant is to be understood in that sense, the record supports plaintiff's claim that investors relied on the covenant in purchasing Authority bonds. But while reliance existed, the covenant cannot be said to have been the "primary consideration" for the purchases having been made, for no witness testified that purchases would *not* have been made without the covenant, but only that they would not have purchased or recommended the purchase of the bonds "at the price which they were then offered."

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 rating services, Moody's and Standard and Poor's. Both have rated Authority bonds as "A" bonds, meaning that they are of investment quality and no default in payment of principal or interest is anticipated. The bonds carried the same rating prior to the enactment of the covenant, after it was enacted, after it was prospectively repealed, and after the repeal act of 1974. As suggested in the reports of the rating services, the rating assigned to Port Authority bonds is an amalgam of many factors, including not only the covenant but "the Authority's strong operating, financial and management record".[31]

Following the 1962 covenant legislation the Port Authority issued 20 series of bonds prior to the enactment of the prospective repeal which became effective on May 10, 1973. The interest rates on these bonds ranged from a low of 3-1/4% (20th series) to a high of 6-5/8% (35th series). After the prospective repeal was enacted, the Authority marketed

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[31]As expressed by one of the witnesses, the Authority "has been well-run, well-organized, well-managed * * *. It's continually shown good revenues."

two additional bond issues, the 40th and 41st series, which carried interest rates of 6% and 5-1/2%, respectively. While it is claimed by plaintiff that the last two series of bonds are indirectly protected by the covenant until the "affected" bonds are retired in the year 2007, it is clear that the interest rates which the Authority has had to pay on non-affected bonds were not materially affected by the absence of direct covenant protection.

Plaintiff also attempted to show through its witnesses and exhibits that the repeal of the covenant adversely affected the secondary market for Authority bonds.[32] This conclusion was expressed by several witnesses who voiced the opinion that not only was the secondary market price of the bonds adversely affected, but that the nature of the market was altered in the sense that the market for the bonds became thin[33] and large institutional investors refused to purchase the bonds after repeal. There can be no question but that immediately following repeal and for a number of months thereafter the market price for Port Authority bonds was adversely affected. This was conclusively demonstrated by plaintiff's exhibits comparing the market price of selected Port Authority bonds, before and after repeal, with the prices of comparable bonds over the same period.

The problem presented by plaintiff's proofs, however, is that they do not show that the adverse effect attributable to the covenant repeal was permanent. Thus, immediately prior to repeal the price of Massachusetts Port Authority bonds was approximately two points higher than that quoted for New York - New Jersey Port Authority bonds having the same interest rate and a similar maturity.[34] The spread in

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[32]The repeal became effective when the concurrent New York legislation was signed by Governor Malcolm Wilson on June 15, 1974.

[33]A "thin" market is one characterized by a low volume of trading in which the price structure of the market is subject to sharp fluctuation by relatively small buy or sell orders.

[34]The bonds prices referred to in the text are derived from Exhibits P-90 and S-3 and the trial transcript.

favor of "Mass Ports" fluctuated immediately after repeal but showed a market tendency to increase until it reached a maximum of 6-1/2 points on August 2. The spread continued to fluctuate thereafter and reached a maximum of 12 points by December 13, 1974. By January 3, 1975 the spread had narrowed to three points, and never exceeded four points through January 23, 1975. By the date of the trial the spread was reduced to two points, which is the same differential that existed prior to the effective date of the repeal.

Furthermore, beginning in August 1974 there were other factors which unquestionably contributed to the adverse price differential prevailing between Port Authority bonds and those of comparable issues. On August 15, 1974 the *Wall Street Journal* carried a story detailing the Authority's problems in completing and renting space in the World Trade Center. Then, on November 10, 1974, the *New York Times* ran a multi-column feature story with the headline "Port Authority Has Fallen on Hard Times." This story, like the one carried by the *Wall Street Journal* in August, referred to the Authority's difficulties at the World Trade Center and its losses on that project, estimated in the article to be as high as $25,000,000 a year.[35] The article also suggested that other Authority facilities which formerly had been profitable were breaking even or losing money. It is to be noted that Port Authority bonds suffered their sharpest decline for the whole period under review during the one month period following the *New York Times* article. On November 8, 1974 the bonds were quoted at 78, and by December 13, 1974 the price had dropped to 65.

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

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[35]The latest available figures disclose that the World Trade Center incurred a deficit for the year 1973 of $16,460,000.

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

The Validity of the Repeal of the Covenant.

[2] Plaintiff's position here is premised on the proposition that the 1962 covenant legislation created a contract between the States of New Jersey and New York and the bondholders of the Port Authority which prohibited the use of Port Authority revenues and reserve funds for passenger railroad purposes except as expressly permitted by the terms of the act. The repeal act of 1974, it is said, impairs the obligation of that contract in violation of *U. S. Const.*, Art. I, § 10 of the United States ("No State shall * * * pass any * * * Law impairing the Obligation of Contract * * *") and *N. J. Const.* (1947), Art. IV, § VII, par. 3. ("The Legislature shall not pass any * * * law impairing the obligation of contracts * * *").[36]

[3] At the outset it is essential to define the terms of the contract and the nature of the impairment claimed by plaintiff. When the 1962 covenant was enacted there was in existence the CBR of 1952, pursuant to which the Authority had pledged its net revenues and the reserve funds as security

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[36]Plaintiff also urges that the repeal act contravenes the Fifth and Fourteenth Amendments of the United States Constitution and Article I, par. 20 of the New Jersey Constitution. The contention is that the repeal constituted a "taking" of property without due process of law, *i. e.*, just compensation. This issue will not be considered in this opinion for the following reasons: (1) to the extent that the claim is based upon an alleged reduction in the secondary market price of Authority bonds, it has been factually rejected *supra*, and (2) the test of constitutional validity as applied to repeal legislation is the same under the Contract and Due Process Clauses, *i. e.*, if an unlawful impairment has occurred there has been a "taking," and if not, then there is no taking. See *Veix v. Sixth Ward B. & L. Ass'n*, 310 *U. S.* 32, 41, 60 S. Ct. 792, 84 L. Ed. 1061 (1940); *Lynch v. United States*, 292 *U. S.* 571, 578–581, 54 S. Ct. 840, 78 L. Ed. 1434 (1934); Hale, "The Supreme Court and the Contract Clause: III," 57 *Harv. L. Rev.* 852, 890 (1944).

for the payment of debt service on all consolidated bonds. The CBR and the series' resolutions, pursuant to which all outstanding consolidated bonds were issued, constitute a contract between the bondholders and the Authority, and that contract was unaffected by the enactment of the 1962 covenant. The covenant superimposed upon the security provisions of the CBR and the series' resolutions the further agreement of the states that neither the Authority's revenues nor its reserve funds would be used for any additional passenger railroad facility whose estimated deficit would exceed 10% of the amount in the general reserve fund.[37] To the extent that the repeal of the covenant authorizes the Authority to assume greater deficits for such purposes, it permits a diminution of the pledged revenues and reserves and may be said to constitute an impairment of the states' contract with the bondholders.[38] *Bronson v. Kinzie,* 42 *U. S.* (1 *How.*) 311, 11 L. Ed. 143 (1843); *Planters' Bank of Miss. v. Sharp,* 47 *U. S.* (6 *How.*) 301, 327, 12 L. Ed. 447 (1848); *Hawthorne v. Calef,* 69 *U. S.* (2 *Wall.*) 10, 17 L. Ed. 776 (1864); *Von Hoffman v. City of Quincy,* 71 *U. S.* (4 *Wall.*) 535, 18 L. Ed. 403 (1867); *W. B. Worthen Co. v. Kavanaugh,* 295 *U. S.* 56, 55 S. Ct. 555, 79 L. Ed. 1298 (1935); *New Jersey Highway Authority v. Sills,* 109 *N. J. Super.* 424 (Ch. Div. 1970), supplemented 111 *N. J. Super.* 313 (Ch. Div.

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[37]The statutory formula for permitted deficits is set forth in more precise detail, *supra* at 162–163.

[38]It is not disputed by defendants that a legislative enactment, such as the 1962 covenant, may constitute a contract. Such has been the law since *Fletcher v. Peck,* 10 *U. S.* (6 Cranch.) 87, 3 L. Ed. 162 (1810). See also, *New Jersey v. Yard,* 95 *U. S.* 104, 114, 24 L. Ed. 352 (1877), where the court said: "It has become the established law of this Court that a legislative enactment * * * may contain provisions which * * * become contracts * * * within the protection of the [Contract Clause]." The legislative history associated with the enactment of the 1962 covenant as well as the statutory language used establish fairly conclusively that the Legislature intended the covenant to be a contract between the states and the bondholders of the Authority.

1970), aff'd 58 *N. J.* 432 (1971); *First Nat'l Bank of Boston v. Main Tpke. Auth.*, 153 *Me.* 131, 136 *A.* 2d 699 (Sup. Jud. Ct. 1957).

[4] The Contract Clause addresses itself not only to the obligation, but also to the remedy and the security furnished to enforce the obligation and assure its performance. The first expression of this view of the Contract Clause occurs in *Green v. Biddle*, 21 *U. S.* (8 *Wheat.*) 1, 5 L. Ed. 547 (1823), which arose out of a compact between Virginia and Kentucky creating the latter as a separate state. Under the terms of the compact Kentucky agreed that all private rights and land titles derived from the laws of Virginia would "remain valid and secure" under Kentucky law. Thereafter, Kentucky enacted a series of laws designed to diminish and impede the remedies available to Virginia claimants to recover possession and the rents and profits of lands occupied by Kentucky residents. In holding the legislation invalid under the Contract Clause, Justice Story said:

> It is no answer that acts of Kentucky, now in question, are regulations of the remedy, and not of the right to lands. If those acts so change the nature and extent of existing remedies, as materially to impair the rights and interests of the owner, they are just as much a violation of the compact as if they directly overturned his rights and interests." [21 *U. S.* (8 *Wheat.*) at 17].[39]

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[39]Upon rehearing in *Green v. Biddle*, Justice Washington delivered the opinion of the court containing perhaps the most extreme expression of the reach of the Contract Clause rendered by the court:

> The objection to a law, on the ground of its impairing the obligation of a contract, can never depend upon the extent of the change which the law effects in it. Any deviation from its terms, by postponing, or accelerating, the period of performance which it prescribes, imposing conditions not expressed in the contract, or dispensing with the performance of those which are, however, minute or apparently immaterial in their effect upon the contract of the parties, impairs its obligation. [21 *U. S.* (8 *Wheat.*) at 8488]

In contrast to the language of Justice Story quoted in the text above, Justice Washington states that *any* impairment, whether or not material to the obligation, violates the Contract Clause. It is

In *Von Hoffman v. City of Quincy, supra,* bonds were issued by a city under existing Illinois law which authorized a special property tax to be levied in an amount sufficient to pay the interest on the bonds. The taxes thus collected were to be held in a separate fund specially pledged for the payment of the interest and not to be used for any other purpose. Subsequently, the legislature enacted a statute which limited the rate of property tax that could be levied by municipalities, and repealed the prior law authorizing the levy of a special tax for the benefit of bondholders. The property taxes collected by the city under the new law were insufficient to pay the interest due on the bonds. A bondholder instituted suit against the city and judgment was entered in his favor for the amount of interest owed on the bonds. The city failed to pay the judgment and refused to levy a property tax for such purpose. The judgment creditor thereupon sought a writ of *mandamus* to compel the city to pay the judgment or to levy a special tax. In its defense the city relied upon the repeal legislation as constituting a valid exercise of the state's sovereign power with respect to future public revenues, as to which it urged no binding contract could exist.[40] The court held the repeal legislation to be an invalid impairment under the Contract Clause. The court reaffirmed the doctrine laid down by Justice Story in *Green v. Biddle, supra,* this time describing the prohibited area in terms of an impairment of "substantial" rights, rather than a "material" impairment.

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 contract is thereby impaired. No attempt has been made to fix definitely the line between alterations of the remedy,

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doubtful whether this view was ever embraced by the court at any time. But see *Planters' Bank of Miss. v. Sharp,* 47 *U. S.* (6 *How.*) 301, 327, 12 L. Ed. 447 (1848); *Ogden v. Saunders,* 25 *U. S.* (12 *Wheat.*) 213, 256, 6 L. Ed. 606 (1827).

[40]The Supreme Court had earlier rejected this argument in a different context. See *New Jersey v. Wilson,* 11 *U. S.* (7 *Cranch.*) 164, 3 L. Ed. 303 (1812).

> which are to be deemed legitimate, and those which, under the form of modifying the remedy, impair substantial rights. Every case must be determined upon its own circumstances. Whenever the result last mentioned is produced, the Act is within the prohibition of the Constitution, and to that extent void. [71 *U. S.* at 553].

In its analysis of the issue presented the court viewed the question as addressing itself to the impairment of a remedy. However, the "remedy" in this context is actually the security furnished for the payment of the obligation, *i. e.,* the authorization to levy a special property tax to pay the interest on the bonds.

This line of authority culminates in *W. B. Worthen Co. v. Kavanaugh, supra,* one of the last adjudications by the Supreme Court declaring repeal or amendatory legislation invalid under the Contract Clause. In *Kavanaugh* bonds had been issued by a municipal improvement district organized under the laws of Arkansas. At the time of issuance the statutory scheme to secure payment of the bonds provided for mortgage benefit assessments to be made against each parcel of property which "contained provisions well planned to make these benefit assessments an acceptable security." 295 *U. S.* at 57, 55 S. Ct. at 555. Thereafter, the legislature amended the statute so as to modify the procedures relative to defaulted obligations. The interest and penalties payable on default were substantially reduced, the time in which the property was to be sold for nonpayment was extended from 65 days to 2½ years, and the property owner was permitted to remain in possession with a right of redemption for a further period of four years without accounting for rents. The court struck down the subsequent legislation under the Contract Clause and in the course of doing so it gave a more precise definition of what constitutes a prohibited impairment. Speaking for the court Justice Cardozo said:

> In the books there is much talk about distinctions between changes of the substance of the contract and changes of the remedy. * * * The dividing line is at times obscure. There is no need for the

purposes of this case to plot it on the legal map. Not even changes of the remedy may be pressed so far as to cut down the security of a mortgage without moderation or reason or in a spirit of oppression. Even when the public welfare is invoked as an excuse, these bounds must be respected. * * * We state the outermost limits only. In stating them we do not exclude the possibility that the bounds are even narrower. The case does not call for definition more precise. A catalogue of the changes imposed upon this mortgage must lead to the conviction that the framers of the amendments have put restraint aside. With studied indifference to the interests of the mortgagee or to his appropriate protection they have taken from the mortgage the quality of an acceptable investment for a rational investor.

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Whether one or more of the changes effected by these statutes would be reasonable and valid if separated from the others, there is no occasion to consider. A state is free to regulate the procedure in its courts even with reference to contracts already made * * * and moderate extensions of the time for pleading or for trial will ordinarily fall within the power so reserved. A different situation is presented when extensions are so piled up as to make the remedy a shadow. * * * What controls our judgment at such times is the underlying reality rather than the form or label. The changes of remedy now challenged as invalid are to be viewed in combination, with the cumulative significance that each imparts to all. So viewed they are seen to be an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security. [295 *U. S.* at 60, 62, 55 S. Ct. at 557].

[5, 6] As the language of the court in the cases cited above makes manifest, not every impairment of a contract obligation or security for its performance runs afoul of the Contract Clause; a state acting under its reserved police powers may alter its remedial processes and thereby diminish contractual security provided it does not destroy its quality as "an acceptable investment for a rational investor." This view of the Contract Clause has its origin in the concurring opinion of Justice Johnson in *Fletcher v. Peck,* 10 *U. S.* (6 *Cranch*) 87, 145, 3 *L. Ed.* 162 (1810). See *Hale, supra* at 873. Justice Johnson's conception of the states' reserved power under the Contract Clause was cogently expressed in his dissenting opinion in *Ogden v. Saunders,* 25 *U. S.* (12 *Wheat.*) 213, 6 L. Ed. 606 (1827), where he said:

> Societies exercise a positive control as well over the inception, construction, and fulfillment of contracts, as over the form and measure of the remedy to enforce them.
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> * * * * * * * *
>
> It is, therefore, far from being true, as a general proposition, "that a government necessarily violates the obligation of a contract which it puts an end to without performance." It 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. [25 *U. S.* (12 *Wheat.*) at 286, 291.]

[7] Justice Johnson's formulation of the police power doctrine as applied to the Contract Clause was quoted with approval and forms the rationale for the court's decision in *Home B. & L. Ass'n v. Blaisdell,* 290 *U. S.* 398, 428–429, 54 S. Ct. 231, 78 L. Ed. 413 (1933). During the span of more than a century between *Ogden v. Saunders* and *Blaisdell* 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.[41] 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

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[41] For a more detailed discussion of the development of the doctrine, see *Wright, The Contract Clause and the Constitution,* 196–213 (1938).

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. Tranbarger*, 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 issue before the court in *Blaisdell* was the validity of the Minnesota Mortgage Moratorium Law. Once again the question was whether the state could exercise its sovereign power to impair the security provisions for the payment of a debt by a significant alteration of the remedies available for its enforcement. The act provided that during the economic emergency declared to exist, the state courts could upon application and notice extend the period of redemption from foreclosure sales and fix the rental value to be paid by the mortgagor in possession. The act also barred any action for a deficiency judgment until after the expiration of the redemption period. The court upheld the con-

stitutionality of the act, and Chief Justice Charles Evans Hughes described the reach of the Contract Clause:

> To ascertain the scope of the constitutional prohibition, we examine the course of judicial decisions in its application. These 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.
> * * * * * * * *
> Not 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, 53 *S. Ct.* 181, 189, 77 *L. Ed.* 288. 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. The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while, — a government which retains adequate authority to secure the peace and good order of society. 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 428, 434–5, 54 S. Ct. at 236]

[8–10] The line of demarcation between *Blaisdell* and *Kavanaugh* may be expressed as one of degree: The states' inherent power to protect the public welfare may be validly exercised under the Contract Clause even if it impairs a contractual obligation so long as it does not destroy it. While Blaisdell placed great emphasis upon the emergency character of the Minnesota law to validate the action taken, decisions of the court since then have sanctioned nonemergent legislation impairing contractual rights and remedies where necessary to protect the economic well being of the state. See *Veix v. Sixth Ward B. & L. Ass'n of Newark,* 310 *U. S.* 32, 60 S. Ct. 792, 84 L. Ed. 1061 (1940); *Gelfert v. National City Bank,* 313 *U. S.* 221, 61 S. Ct. 898, 85 L. Ed. 1299 (1941). Furthermore, in keeping with the principles set forth in *Kavanaugh,* we must deal with realities and not abstractions, for "[t]he Constitution is 'in-

tended to preserve practical and substantial rights, not to maintain theories.'" *Faitoute Iron & Steel Co. v. City of Asbury Park,* 316 *U. S.* 502, 514, 62 S. Ct. 1129, 1133, 86 L. Ed. 1629 (1942).

The most recent case dealing with the issue, and that upon which defendants place greatest reliance, is *City of El Paso v. Simmons,* 379 *U. S.* 497, 85 S. Ct. 577, 13 L. Ed. 2d 446, reh. den. 380 *U. S.* 926, 85 S. Ct. 879, 13 L. Ed. 2d 813 (1965). The facts of the case may be briefly summarized. Texas law had provided for the sale of public lands on easy credit terms to raise money for school funds and to encourage land settlement. The credit terms set forth in the law governing such sales included a provision permitting the contract owner, were the land forfeited back to the State for nonpayment of interest, an unlimited time in which to reinstate the contract by payment of back interest, subject only to the rights of intervening 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. Upon expiration of this five-year period the State would have clear title. Simmons, owner of a quitclaim deed to land contracted for in 1910, had not made timely payment of the interest arrearages. His contract title was forfeited by the state which subsequently transferred the land to the City of El Paso. He instituted suit against the city to determine title to the land, urging that the 1941 law was a violation of the Contract Clause since it not only impaired his contractual right of reinstatement but destroyed it completely.

The 1941 legislation was held by the court to constitute a valid exercise of the state's power to modify or affect the obligation of its contracts. The essential question, in the court's view, was not whether the statute impaired the "obligation" or the "remedy", for not "every modification of a contractual promise * * * [or] every alteration of existing remedies * * * violates the Contract Clause." 379

U. S. at 506–507, 85 S. Ct. at 582. Rather, the question was whether the modification of the contractual obligation to reinstate the purchaser's title was reasonable on the facts disclosed. Citing the legislative history, the court noted that Texas had a vital interest in "the integrity of land titles" and in the administration "of its property in a businesslike manner" (379 *U. S.* at 511–12, 85 S. Ct. at 585) and

> * * * [t]he Contract Clause of the Constitution does not render Texas powerless to take effective and necessary measures to deal with [these matters]. * * * [T]he promise of reinstatement, whether deemed remedial or substantive, was not the central undertaking of the seller nor the primary consideration for the buyer's undertaking. * * * We do not believe that it can seriously be contended that the buyer was substantially induced to enter into these contracts on the basis of a defeasible [*sic*] right to reinstatement in case of his failure to perform * * *. We, like the Court in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 *U. S.* 502, 514, 62 *S. Ct.* 1129, 1135, 86 *L. Ed.* 1629, believe that "[t]he Constitution is 'intended to preserve practical and substantial rights, not to maintain theories.' * * *." 379 *U. S.* at 513–515, 85 S. Ct. at 586.
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> * * * * * * * *
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> The measure taken to induce defaulting purchasers to comply with their contracts * * * was a mild one, indeed, hardly burdensome to the purchaser who wanted to adhere to his contract of purchase, but nonetheless an important one to the State's interest. The Contract Clause does not forbid such a measure. [379 *U. S.* at 516–517, 85 S. Ct. at 588]

The view of the Contract Clause and its subservience to the police power as expressed in *Blaisdell* and *El Paso* coincides with the interpretation placed upon the Contract Clause of the New Jersey Constitution as interpreted by our highest courts. Thus, in *Hourigan v. North Bergen Tp.*, 113 *N. J. L.* 143 (E. & A. 1934), Justice Heher cited *Blaisdell* with approval for the proposition that "the reservation of essential attributes of sovereign power" is to be read into the contracts of the State. He there defined the police power as

> * * * an exercise of the sovereign right of the government to protect the lives, health, morals, comfort and general welfare of the people and [it] 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. [at 149]

[11] Neither *New Jersey Highway Auth. v. Sills, supra,* nor *New Jersey Sports & Expos. Auth. v. McCrane,* 61 *N. J.* 1 (1972), app. dism. 409 *U. S.* 943, 93 S. Ct. 270, 34 L. Ed. 2d 215 (1972), suggests that our present Supreme Court has adopted a narrower interpretation of the Contract Clause of either the State or the Federal Constitutions. In *Sills* the court viewed a statute exempting National Guardsmen from the payment of tolls on the Parkway as "ordinary and relatively unimportant legislation" not intended to deal with "any problem of state-wide importance" as was the case in *El Paso* (111 *N. J. Super.* at 320). And in *McCrane* the Supreme Court expressly affirmed that while a contract between the State and the bondholders of an independent governmental authority is entitled to protection under the State and Federal Constitutions, such contracts are nevertheless subject to "a proper exercise of the State's never abdicated police powers." 61 *N. J.* at 26.[42]

[12] The history of the creation and evolution of the Port Authority establishes beyond peradventure that it was intended by the states and by the Congress to perform govern-

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[42]In their brief and at oral argument defendants ask the court to pass upon the validity of the New York repeal act under the New York Constitution. While it would unquestionably be desirable to do so in the interest of resolving all issues within the context of this litigation, that question should be left to the New York courts for decision. *Cf. Interstate Wrecking Co. v. Palisades Interstate Park Comm'n,* 57 *N. J.* 342, 352 (1971). It may be noted that U. S. Trust has filed a declaratory judgment action in the New York Supreme Court which is presently pending.

mental functions necessary and vital to the public safety, health and welfare of the citizens of the two states and the nation as well. *Cf. Comm'r of Int. Rev. v. Ten Eyck,* 76 *F.* 2d 515, 518 (2 Cir. 1935). The states have a continuing interest in and can never abdicate their sovereign powers to control and direct the activities of the Authority to meet the everchanging needs of a complex society. See *Blaisdell, supra,* 290 U. S. at 442, 54 S. Ct. 231. Senator Farley summed it up when he advised Commissioner Kellogg in 1961:

> * * * I appreciate that if the Legislature directs you to enter into a contract involving the issuance of bonds, there will be no impairment of obligations of contract, but I must call to your attention and the members of your Commission that one Legislature cannot bind a subsequent Legislature involving policy. If, perchance, may I illustrate — ten, fifteen, twenty years from now the respective legislatures of New York and New Jersey importune your Port Authority Commission to do something in addition involving public service, one legislature cannot bind another involving policy. [*Supra* at 157]

The interest of the states in the development of a coordinated system of public and private transportation within the Port District has been spread on the public record for more than 50 years, and legislative action to accomplish that objective clearly involves an exercise by the states of their fundamental sovereign powers. The enactment of the 1962 covenant was indeed an attempt to satisfy an immediate public need to preserve the H&M as a viable public transportation system. The passage of time and events between 1962 and 1974 satisfied the Legislatures of the two states that the public interest which the Port Authority was intended to serve could not be met within the terms of the covenant.

[13, 14] The events which occurred between the passage of the covenant and its repeal are described elsewhere in this opinion (*supra* at 167–176) and need not be detailed again. Suffice it to say that between 1962 and 1974 the security afforded bondholders had been substantially augmented by a vast increase in Authority revenues and reserves, and the Authority's financial ability to absorb greater deficits, from

whatever source and without any significant impairment of bondholder security, was correspondingly increased.[43] During the same interval mass transit facilities within the District continued to deteriorate while the public need for such facilities became unprecedented as the result of the promulgation of stringent federal air pollution regulations designed to reduce automobile usage and the emergence of an energy crisis which threatened the entire system of private automobile transportation in the two States.[44]

"The motive, the policy [and] the object" of the repeal legislation, read against its background, was to further a vital interest of the states which their Legislatures deemed to be essential to the public good. The question is whether the exercise of such power falls within the prohibited scope fo the Contract Clause, or does it, in the language of Chief Justice Hughes in *Blaisdell,* represent "a rational compromise between the individual rights and the public welfare." 290 *U. S.* at 442, 54 S. Ct. at 241.

Conceding the existence of some impairment of bondholder security as a result of the repeal, has the action of

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[43]Between 1961 and 1973 the net revenues of the Authority increased from $68,000,000 to $137,000,000, and over that period the Authority had available to it $582,732,000 in excess of its debt service requirements, after taking into account the deficits of the H&M. Through 1974, the corresponding figures are $161,283,000 and $649,750,000, respectively.

[44]Plaintiff urges that none of the legislative history (detailed at 167–176, *supra*) which preceded the repeal of the covenant should be considered relevant to the question of whether the repeal constituted a reasonable exercise of the states' police powers inasmuch as the repeal legislation was unnecessary and the Legislature made no findings or declarations with respect to such matters. A judgment as to the necessity of the legislation is for the Legislature and not the courts. See *Hourigan v. North Bergen Tp.*, *supra* 113 *N. J. L.* at 149. Nor is the Legislature required to make explicit findings and declarations within the context of the legislation to support an exercise of the police power. See *Gelfert v. Nat'l. City Bank of N. Y.*, *supra* 313 *U. S.* at 235, 61 S. Ct. 898; *Bucsi v. Longworth B. & L. Ass'n*, 119 *N. J. L.* 120, 122 (E. & A. 1937), app. dism. 305 *U. S.* 665, 59 S. Ct. 154, 83 L. Ed. 431 (1938).

the states destroyed the quality of their security as an "acceptable investment for a rational investor"? The repeal, of course, leaves intact the provisions of the CBR and the series resolutions which now constitute, together with the General Reserve Fund Act, the same measure of the bondholders' contractual security rights as existed prior to the enactment of the covenant in 1962. Presumably, rational investors—including plaintiff—purchased hundreds of millions of dollars of consolidated bonds prior to 1962, without the additional security afforded by the covenant and with full knowledge of the power of the states to direct the Authority into mass transit operations. The two principal bond rating services, upon whose judgment the financial community places great reliance, rated the consolidated bonds—minus the covenant —as securities as to which no default was anticipated.

The claim that bondholder security has been materially impaired or destroyed by the repeal is simply not supported by the record. The pledge of the Authority's net revenues and reserves remains intact; the Authority will still be barred from the issuance of any new consolidated bonds unless the 1.3 test required by the CBR is met, and the Authority will continue to be prohibited from the issuance of any consolidated bonds or other bonds secured by a pledge of the general reserve fund without the certification required by section 7 of the series resolutions, to wit, that in the opinion of the Authority the estimated expenditures in connection with any additional facility for which such bonds are to be issued would not, for the ensuing ten years, impair the sound credit standing of the Authority, the investment status of its consolidated bonds, or the Authority's obligations to its consolidated bondholders.

[15] Plaintiff's claim of an unconstitutional impairment is predicated upon such slender reeds as the assertion that the "quality" of the certification required under the CBR and section 7 need not be as "objective" as that required under the covenant; the speculation that the good judgment of the Authority's commissioners in making the necessary

certifications will be overborn by the "political pressures" exerted by the Governors of the States,[45] and the self-flagellating prospect that the states will conspire to "give" the New York City subway system to the Authority and thereby destroy not only the bondholders' security but the Port Authority as well. But as the court stressed in *Faitoute, supra,* constitutional questions must be decided in the world of reality and not by resort to abstract speculations of the kind offered by plaintiff.

[16, 17] The thrust of plaintiff's argument is that any impairment of the security provisions of a contract violates the Contract Clause. It seeks to recreate a theory of the Contract Clause which, if ever imbedded in our constitutional law, no longer exists. As reflected in the course of more than 150 years of its judicial interpretation, the Contract Clause must be construed in harmony with the power of the states to alter or modify their contractual obligations where an important public interest requires. 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 that "the reservation of [the] essential attributes of sovereign power" is as much a part of their contract as that which is expressly stated.

[18] It is the judgment of this court that the repeal legislation was a reasonable and hence valid exercise of the states' police power which is not prohibited by the Contract Clause of either the Federal or the State Constitution. An order will therefore be entered dismissing the complaint of plaintiff and in favor of defendants on so much of their counterclaim as seeks a declaratory judgment with respect to the constitutional validity of *chapter* 25 of the *Laws of* 1974.

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[45]At the same time plaintiff argues that the covenant's requirement of a certification by the Governors is an "added" protection afforded them by the covenant.

In view of the court's holding in the U. S. Trust action, defendant's third separate defense (asserting the invalidity of the 1962 covenant) and the complaint in the *Gaby* action will be dismissed. See *Wagner v. Ligham,* 37 *N. J. Super.* 430 (App. Div. 1955).

APPENDIX B

The 1962 Covenant

32:1–35.55 Covenant with bondholders; certification by port authority

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.

"Affected bonds" as used in this section shall mean bonds of the port authority issued or incurred by it from time to time for any of the purposes of this act or bonds as security for which there may or shall be pledged, in whole or in part, the general reserve fund or any reserve fund established by or pursuant to contract between the port authority and the holders of such bonds, or the revenues of the world trade center, Hudson tubes, Hudson tubes extensions or any other facility owned or operated by the port authority any surplus revenues of which would be payable into the general reserve fund, or bonds both so issued or incurred and so secured.

"Permitted purposes" as used in this section shall mean purposes in connection with (i) the Hudson tubes as authorized and limited on the effective date of this covenant

and agreement, (ii) railroad freight transportation facilities or railroad freight terminal facilities, (iii) the construction, installation and maintenance of railroad tracks and related facilities on vehicular bridges owned by the port authority, and (iv) any other railroad facility established, acquired, constructed or otherwise effectuated by the port authority (including but not limited to Hudson tubes extensions) as to which the port authority shall have first certified either that said other railroad facility is self-supporting as hereinafter defined or, if not, that at the end of the preceding calendar year the general reserve fund contained an amount equal to 1/10 of the par value of bonds of the port authority which were outstanding at said year end and which were legal for investment as defined in the general reserve fund statutes and that the group of facilities consisting of such other railroad facility and of all prior other railroad facilities will not produce deficits in excess of permitted deficits as hereinafter defined. "Prior other railroad facilities" at the time of any certification by the port authority hereunder shall mean all the railroad facilities described in subdivisions (i) and (iv) of this paragraph which were theretofore established, acquired, constructed or otherwise effectuated by the port authority any surplus revenues of which at such time would be payable into the general reserve fund.

An other railroad facility shall be deemed to be "self-supporting" as of the time of any certification hereunder if the amount estimated by the port authority for the ensuing 10 years to be the average annual net income (computed without deduction for 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.

"Deficits" of a group of railroad facilities, as used in this section, shall mean the amount estimated by the port authority for the ensuing 10 years to be the average annual combined debt service upon bonds for purposes in connection with the railroad facilities of such group less the amount estimated by the port authority for such 10 years to be the average annual combined net income (computed without deduction for debt service) derived from or incidental to such railroad facilities or plus the amount estimated by the port authority for such 10 years to be the average annual combined net losses (computed without deduction for debt service) sustained from or incidental to such railroad facilities; the estimate of deficits thus arrived at shall not be effective unless and until concurred in, in writing, by the Governors of the said 2 States.

"Permitted deficits" of a group of railroad facilities as used in this section, shall mean deficits as of the time of any certification hereunder which do not exceed (A) such amount or amounts of deficits as of the time of any certification hereunder for the payment of which 1 or both of the 2 States, in connection with the proposed other railroad facility as to which the certification is made and in connection with prior other railroad facilities, has made adequate, secure and effective provision for the duration of the period for which the port authority is liable for such deficits, plus (B) the greater of the following 2 amounts: (1) an amount equal to 1/10 of the amount in the general reserve fund at the end of the preceding calendar year, diminished by an amount equal to 1% of the principal amount of all bonds of the port authority outstanding at

the end of said preceding calendar year the proceeds of which shall have been applied for purposes in connection with the facilities of such group or (2) an amount equal to the sum of 1/10 of the diminished 1/10 amount calculated under clause (1) of this sentence, plus 1% of the equity, at the end of the said preceding calendar year, of the port authority in its vehicular bridges and tunnels and in all other facilities owned and operated by it (not including railroad cars financed by state-guaranteed bonds) except those of the aforesaid group of railroad facilities. Equity of the port authority in facilities as to which any calculation of equity shall be made shall mean the principal amount of bonds of the port authority retired from port authority revenues or reserves or both which have been derived from the operation of its facilities and the investment of its funds and not from governmental or other subsidy payments, the proceeds of which retired bonds shall have been applied for purposes in connection with such facilities.

Each certification by the port authority hereunder shall be made at the time of the issuance of its first bonds for permitted purposes in connection with a proposed other railroad facility which bonds would be secured in whole or in part by the aforesaid pledged rentals, tolls, fares, fees, charges, revenues or reserves, or at such time, prior to such issuance, as any application of such pledged rentals, tolls, fares, fees, charges, revenues or reserves for purposes in connection with such proposed other railroad facility would otherwise be permitted or required. Anything herein to the contrary notwithstanding, any such certification by the port authority hereunder shall not be effective unless and until affirmatively concurred in, in writing, by the Governors of the said 2 States. L.1962, c. 8, § 6.

Chapter 25, Laws of 1974

AN ACT to repeal section 3 of "An act authorizing the Port Authority of New York and New Jersey to provide improved passenger railroad service as an extension of the Hudson tubes (now known as Port Authority Trans-Hudson) between the cities of Newark and Plainfield in the State of New Jersey, providing that a statutory covenant relating to the application of the revenues and reserves of the port authority shall not extend to the holders of bonds hereafter issued, and amending and supplementing 'An act to provide for the financing and effectuation by the Port of New York Authority of a port development project, consisting of the Hudson tubes, the Hudson tubes extensions and a world trade center, for coordinating, facilitating, and promoting the transportation of persons and the flow and exchange of trade and commerce in and through the Port of New York District, and agreeing with the State of New York with respect thereto,' approved February 13, 1962 (P. L. 1962, c. 8)" approved December 28, 1972 (P.L. 1972, c. 208) and supplementing said act.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey*:

C. 32:1-35.55a Repealer.

1. Section 3 of "An act authorizing the Port Authority of New York and New Jersey to provide improved passenger railroad service as an extension of the Hudson tubes (known as Port Authority Trans-Hudson) between the cities of Newark and Plainfield in the State of New Jersey, providing that a statutory covenant relating to the appli-

cation of the revenues and reserves of the port authority shall not extend to the holders of bonds hereafter issued, and amending and supplementing 'An act to provide for the financing and effectuation by the Port of New York Authority of a port development project, consisting of the Hudson tubes, the Hudson tubes extensions and a world trade center, for coordinating, facilitating, and promoting the transportation of persons and the flow and exchange of trade and commerce in and through the Port of New York District, and agreeing with the State of New York with respect thereto,' approved February 13, 1962 (P. L. 1962, c. 8)," approved December 28, 1972 (P. L. 1972, c. 208, C. 32:1-35.55a) is repealed.

2. If any section, part, phrase, or provision of this repealer act or the application thereof to any person, project or circumstances, be adjudged invalid by any court of competent jurisdiction, such judgment shall be confined in its operation to the section, part, phrase, provision or application directly involved in the controversy in which such judgment shall have been rendered and shall not affect or impair the validity of the remainder of this act or the application thereof to other persons, projects or circumstances, and the two states hereby declare that they would have entered into this act or the remainder thereof had the invalidity of such provision or application thereof been apparent.

3. This act shall take effect upon the enactment into law by the State of New York of legislation having an identical effect with this act, but if the State of New York has already enacted such legislation, this act shall take effect immediately.

Approved April 30, 1974.

Notice of Appeal to the Supreme Court of the United States

(*Stamp*)
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SUPREME COURT
OF NEW JERSEY

[Filed: May 14, 1976]

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SUPREME COURT OF NEW JERSEY
Civil Action

Docket No. 11498

UNITED STATES TRUST COMPANY OF NEW YORK, etc.,

Appellant,

—v.—

THE STATE OF NEW JERSEY, *et al.*,

Appellees.

Notice is hereby given that United States Trust Company of New York, the appellant above named, hereby appeals to

the Supreme Court of the United States from the final judgment of the Supreme Court of New Jersey affirming the judgment of the Superior Court of New Jersey, Law Division, Bergen County, in this action, which judgment of the Supreme Court of New Jersey was entered on February 25, 1976.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

MEYNER, LANDIS & VERDON
By ROBERT B. MEYNER

CARTER, LEDYARD & MILBURN
By DEVEREUX MILBURN