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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1687

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

Appellant,

v.

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

Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

REPLY BRIEF FOR APPELLANT

Appellant submits this brief in reply to the brief for appellees dated September 11, 1976.

Appellees' brief can be divided, for purposes of analysis, into categories: (1) the history of the Port Authority and the reasons for the Covenant's enactment; (2) the damage to bondholders resulting from repeal; (3) the reasons for the Covenant's repeal; (4) the constitutional validity of repeal; and (5) the constitutional validity of the Covenant, when it was enacted in 1962.

The History of the Port Authority and the Reasons for Enactment of the Covenant.

Much of appellees' "history" of the Port Authority is based on inaccurate references to Professor Erwin Bard's monograph, *The Port of New York Authority,* published in 1942. Appellees cite Bard to support the statement that the Port Authority refused in 1922 to help solve the problems of railroad passenger traffic. (Ap. B.[1] 3). What Bard actually said was that "the Port Authority felt that its resources would be fully occupied with the freight problem, *which it was created to solve,* for some time to come." (BARD at pp. 65-66) (footnote omitted; emphasis added). Nowhere did or could Bard suggest, as appellees say[2], that the Comprehensive Plan was not implemented because of any refusal to help on the part of the Port Authority. The New Jersey Legislature, in 1922, said that the Comprehensive Plan Legislation "does not include the problem of passenger traffic in the territory covered by said port development plan" (Ch. 104, Laws of New Jersey of 1922). More important, the superior court specifically found that neither the Commission which recommended the creation of the Port Authority (A. 65-66) nor the Comprehensive Plan itself (A. 69) contemplated any responsibility by the agency in the field of passenger transit.

Appellant (A.B. 8) and appellees (Ap. B. 5 fn. 6) differ in their interpretation of Governor Smith's veto of Port Authority involvement in rail mass transit in 1927; to settle the dispute we quote the veto message:

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1. "Ap. B" refers to the Brief for Appellees. "A" refers to the Single Appendix.

2. Appellees cite Bard at 65-66 and 128-130 to support this; Bard actually said "the Port Authority had felt that its resources would be fully occupied with the freight problem. . . ." (at 128).

> "[I]t has been a great disappointment to me to find that the opposition of the railroads has prevented to date the making of real progress in working out the problem of freight distribution in the port which always has been the main object and purpose of the Port of New York Authority. I am satisfied that the Port Authority should stick to this program and I am entirely unwilling to give my approval to any measure which at the expense of the great freight distribution problem will set the Port Authority off on an entirely new line of problem connected with the solution of the suburban passenger problem.
>
> "For the above reasons, the bill is disapproved.
>
> (Signed) Alfred E. Smith" (A. 573-74)

Governor Smith was an architect of the original Compact and knew as well as anyone "the main object and purpose" of the Port Authority. Thirty-two years later the Legislatures of both States, in continued recognition of this fact, created in 1959 the New York-New Jersey Transportation Agency:

> "as a public agency of the states of New York and New Jersey in dealing with matters affecting public mass transit within and between the 2 states." N.J.S.A. 32:22A-6.

Would New Jersey and New York create a new mass transit agency (Chs. 13 and 14, Laws of New Jersey of 1959; Ch. 420, Laws of New York of 1959) and secure the consent of Congress to their bi-state legislation (73 Stat. 575 (1959)), if the Port Authority was already charged with this responsibility?

Appellees attempt to create the impression that the Port Authority is an entity apart from the States which created it, often acting contrary to the best interest of the States

and in conflict with its basic charter[3] (e.g. Ap. B. 5, 6 fn. 7, 10-14, 26 fn. 15). The fact is that every project undertaken by the agency was the subject of specific bi-state legislative authorization or direction; every minute of the meetings of the Commissioners was subject to the veto of either governor; and every resolution, including those providing increased security for bondholders (Ap. B. 6 fn. 7), was in this fashion approved by the governors of both states.

Appellees to the contrary notwithstanding, a basic Port Authority financing principle is that "the specific projects undertaken by the Authority should be self-supporting, *i.e.*, the revenues of each should be sufficient to cover its operating expenses and debt service requirements". The establishment of the General Reserve Fund in 1931 did not, as appellees say (Ap. B. 7), automatically eliminate the requirement that individual facilities be self-supporting; in fact the General Reserve Fund did not reach its statutory level until 1946, and in the 30 years following its creation no project was undertaken by the agency which was not expected, after a development period, to be self-supporting. In 1961 the then Executive Director of the Port Authority testified:

> "[W]e have never gone into any field before where we couldn't look a bondholder in the face and say, 'We honestly believe that we can make this self-supporting and that you'll get your money back.' We have been wrong. In the case of the motor truck terminals, certainly we were wrong. And those terminals by themselves have not earned enough and without the pooling of the general reserves wouldn't be enough." (A. 648; Statement of Executive Director of the Port Authority before the Farley Committee, May 5, 1961).

3. It is remarkable to contrast appellees' history of the Port Authority with the agency's even-handed view of itself in pages 1-21 of its Motion to Dismiss Appeal of Daniel M. Gaby dated June 7, 1976.

The dangers inherent in grouping projects, with the resulting necessity for other controls, was recognized by Professor Bard in 1942. Witness the remainder of the quotation appellees cut short (Ap. B. 7):

> "If existing revenues were ample and dependable the banker would need to give as little scrutiny to the self-sustaining capacity of the new project as he would to a similar project under consideration by an agency supported by the taxing power. In sum, as autonomous borrowing power becomes fully implemented, the safeguard supposed to reside in the scrutiny of the bankers fade out. *Similarly the agency itself is less constrained to estimate conservatively. It may now proceed with projects which only speculative estimates could justify as self-sustaining, or which may not be self-sustaining at all. The way to increased construction is opened, but the safeguard against unjustified expenditure is removed.*" BARD at 325.

As Professor Bard also said:

> "On the other hand, any plan to group projects will bear careful watching as it tends to dissolve the responsibility that any particular project shall be self-sustaining. The concept of self-sustaining then becomes a description of the method of financing rather than an economic justification. In that event thought must be given to imposing other criteria and controls upon the autonomous construction of public works." BARD at 265-66.

When the acquisition of the H & M, the first perpetual deficit facility ever to be considered by the Port Authority, became a possibility, thought was given, as Bard predicted, "to imposing other criteria and controls". The result was the 1962 Covenant. The purpose of the Covenant was to prevent, after the acquisition of the H & M, the entry of additional deficit-ridden railroads into the General Reserve

Fund family except upon compliance with reasonable restrictions. The Covenant was necessary precisely for the reason that the so-called Section 7 certification did not accomplish this purpose. Although appellees try to create a different impression by a truncated quotation of one phrase from a 1961 speech by the then General Solicitor of the Port Authority (Ap. B. 10), what Mr. Goldberg actually said about the Section 7 certification makes it clear that the provision was intended as nothing more than a reiteration of the common law, not some dramatic new protection for bondholders:

> "To us, this [the Section 7 certification] was merely a contractual codification of an agreement and obligation which we had anyhow, but it has helped to allay the fears of the financial community." (A. 840).

Although the H & M was hopelessly bankrupt, with sufficient cash to operate for only two years, and all other mass transit systems within the Port District were deficit-ridden, the Port Authority is accused by appellees of manipulating investor concern with respect to unquantified involvement of the agency in deficit rail mass transit. (Ap. B. 10-14). But appellees cite nothing in support of this conclusion which was not spread on the public record in 1961 as part of the well-publicized Celler Committee hearings, and known to the Farley Committee in New Jersey when the Covenant concept was being studied; nor was that committee shocked by the conclusion of Commissioner Kellogg that the agency could never secure the private financing of perpetual deficit rail mass transit without statutory limits on the agency's involvement, a conclusion now labelled an "extraordinary claim" by appellees (Ap. B. 15). Appellees also distort the uncontradicted testimony of Mr. John Thompson, the dean of municipal bond analysts, to the same effect. Mr. Thompson said categorically that the Covenant was enacted in

response to investor concern at the time that the H & M would be only a first step in increasing involvement of the agency in deficit rail mass transit (A. 854-861).[4]

Appellees conclude that the Legislatures in effect were forced by their own agency to enact the 1962 Covenant as a condition to Port Authority takeover of the H & M (Ap. B. 16-17). They charge that Appellant "erroneously characterizes" the 1959 Joint Assembly Committee report on Assembly Bill No. 16. In a footnote they quote *half* of a sentence from that report but do not indicate that theirs is only a *partial* quotation. What the Committee actually said was that while the Authority:

> "no doubt could undertake an activity which would involve a deficit—even a permanent one—*it could only do so if there were real assurance that the size of the deficit would be such that there could be no doubt of its ability to absorb it*" (A. 594). (Emphasis added.)

The emphasized portion of the quote, which in effect predicted the quantified undertaking which was effected by the 1962 Covenant, was omitted by appellees without any indication of a deletion (Ap. B. 16 fn. 10).

In the same vein appellees say that the 1959 Committee "concluded that the Authority should assume some mass transit deficits" (Ap. B. 16) but they do not *quote* the Committee report which said that such assumption should be only of "modest deficit operations of a predictable nature" (A. 596), *not* an unquantified assumption of a rail mass transit facility.

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4. "I think it was the result of this Covenant not to go further in this field that upheld the credit and borrowing power of the Port Authority over these years, and that was its purpose. It was not to give some bounty to the bondholders. It was to uphold the borrowing power of the Port Authority as an agency of the two states for the enterprises which the two states had assigned to it" (A. 860-861).

Appellees[5] offer a complete redefinition of the aims of bondholders:

> "In reality, and as Dr. Bard found back in 1942[6] and the Assembly Committees reported in 1959,[7] bondholders needed assurance that the Port Authority would not be so burdened with deficits that its profitable facilities might have difficulty carrying them." (Ap. B. 20).

Investor concern was much more specific—potential investors needed assurance that the Port Authority was not about to embark upon an unquantified and unquantifiable journey into an area calculated to assure perpetual deficits, increasing deficits, caused by the economic impossibility of making rail passenger transit self-supporting. It was this single specific concern that John Thompson and his clients were afraid of, that prompted the United States Trust Company of New York, then the largest single holder of Port Authority bonds, to cross them off the approved list until the Covenant was enacted.

Damage to Bondholders as a Result of Repeal

Appellees bitterly attack the two independent grounds of impairment which were demonstrated below: (1) that repeal cancelled a security device valuable to bondholders and (2) that repeal adversely affected the secondary market for the bondholders' investments.

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5. Appellees suggest in a footnote (Ap. B. p. 17 fn. 11) that there was no legislative history annexed to the 1962 legislation embodying the Covenant. They do not quote Governor Rockefeller's message on signing the legislation:

> "To preserve the Port Authority's credit strength the bill includes a covenant by the two States that additional deficit financing of future railroad projects will only be undertaken within the financial limits set forth in their covenant" (A. 675).

6. Dr. Bard made no such finding.

7. The Assembly Committees made no such report.

In discussing the "objective" protections for bondholders which preceded the Covenant's adoption and which remain after repeal appellees rely strongly on a statement by Mr. Goldberg, concurred in by Mr. Zarin, that Port Authority revenues could not simply be diverted to "subsidize the private railroads to the extent of their commuter operating deficits." (Ap. B. 21). This is a true statement, one that Appellant has never questioned, since Section 7 of the Series Resolutions[8] requires that a deficit facility first be brought *into* the General Reserve Fund family before it can be nourished by revenues from other facilities. Appellees, however, purport to reason from this that the Covenant was "redundant", while admitting, as they did in the courts below, that *only* the Covenant would prevent perpetual deficit rail operations in addition to PATH from entering the Port Authority structure. Appellants again admit this later in their brief (Ap. B. 59, 61).

Appellees then say that before the Covenant was enacted it was impossible for the Port Authority to take on any mass transit project that might "endanger the bondholders' security" (Ap. B. 22), admitting in effect that *only* by the Covenant's enactment as a statutorily prescribed limit on the Port Authority's financial participation was the agency able to make any material contribution in this area.

Appellees go on to describe the 1.3 test and the "[o]ther bondholder protection"[9] that preceded the Covenant as reasons why the Covenant "added nothing"

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8. At Ap. B. 22 appellees, by parsing the requirement of *one* opinion into three separate phrases, create "three conditions" where one opinion stood before.

9. One of which is described by appellants to mean that "the Authority is contractually obliged to run in the black" Ap. B. 25. Every municipal obligor that ever defaulted was "contractually obliged to run in the black." Appellees no longer cite, as they did in their lower court briefs, as "perhaps the most important" bondholder protection the agreement by the two States that they will not diminish or impair the power of the Port Authority to levy tolls

(Ap. B. 25). If appellees are correct private investors should have welcomed the entry of a revenue bond agency into a perpetual deficit field since "existing protections" were more than adequate.[10]

Appellees take issue with Appellant's analysis of the 1.3 test, concluding that:

> "Since the building of a facility that would generate deficits large enough to cause future difficulty with the 1.3 test would bring the Port Authority to 'the point of enforced stagnation', end its 'ability to finance any future projects', and endanger the Port Authority 'as a healthy, vigorous organization,' the building of such a facility would obviously run afoul of the Section 7 certification requirements" (Ap. B. 28).

This is simply an erroneous conclusion of appellees with no support, in Section 7, the record or otherwise.

Appellees next contend that the Covenant's requirement of a "self-supporting" certification is qualitative rather than quantitative. They question Mr. Thompson's testimony precisely on this point (A. 872) but they did not attempt to offer any contradictory evidence. Instead they say that this conclusion was rejected by the Farley Committee (which did not reject it), by the Port Authority (which employs it, describing the Covenant as a "one-times

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in connection with any facility owned or operated by the Port Authority the revenues of which shall have been pledged as security for bonds. It is understandable that appellees have changed their minds about the importance of this provision, since this is the same provision which the States so clearly ignored in 1973 and 1974 when they forced the Port Authority to withdraw its PATH fare increase application (A.B. 16 fn. 12).

10. Appellees cite "other bondholders protections" to include "provision for sinking fund payments" and "schedules of mandatory periodic requirement of bonds." Thus, to appellees, provisions requiring payment of bonds when due are to be equated with "bondholder protections".

coverage test", A. 1067) and by the Port Authority's auditors (who never considered the point, but rather only considered allocation of *past* revenues, A. 650-651, 732-36, not estimates of *future* revenues). Although appellees question the conclusion that the Covenant's requirement is considerably more precise a calculation than Section 7's since the Covenant examines only one facility (Ap. B. 29-30), who in this day and age can seriously contend that a rail passenger transit facility can itself be self-supporting[11] under any conceivable test? Appellees have no difficulty at all in suggesting this conclusion.

Appellees then attack Appellant's contention that only the Covenant would prevent a diversion of at least $128.4 million on the PATH-Plainfield project by saying that the argument is "confusing" because based on a "rejected" plan (Ap. B. 31). The plan has now been tentatively approved, and one certain feature is that diversions of Port Authority revenues far in excess of $128.4 million are contemplated.

Appellees continue to insist that rail mass transit diversions will actually come from "the more than $40 million in annual revenues that the Authority has already begun to collect as a result of the toll increase instituted in May 1975 for the specific purpose of financing mass transportation projects. . . . In three or four years, the Port Authority will have earned the entire $128.4 million even though it will have spent far less" (Ap. B. 31-32). This, respectfully, is nonsense. In a footnote appellees charge that Appellant "invents something" it calls "surplus reserves in excess of

11. "Self-supporting" is a rather fundamental concept. You set up an equation and add up the revenues on one side and the expenses and debt service on the other. One side of the equation will either be equal to or will exceed the other side. It is that simple. One wonders why appellees protest this concept so strongly, if not to lay the foundation for a future certification by the commissioners, appointed by the governors, that self-supporting means something else.

mandated bonded debt service" and that Appellant "asserts that this creature grew by only $296,000 in 1975." (Ap. B. 32 fn. 21). We call the Court's attention to pages 738a-739a of the Single Appendix, which sets forth the distribution of income analysis which was included in the Stipulation Among Counsel dated December 20, 1974. The bottom line, at A. 739, is the so-called "invention" of Appellant—the Port Authority's surplus reserves in excess of mandated bonded debt service. As the Stipulation makes clear, this distribution of income analysis was *provided by the Port Authority* at the request of counsel for Appellant (A. 738).

Then appellees complain that "[n]o page or chart of the [1975 Annual] Report itself is cited" to explain how the amount was calculated. Appellees know full well how the amount was calculated; it was calculated in exactly the same way as the chart in the Stipulation Among Counsel was calculated. Thus, net revenue before debt service was $198.6 million in 1975 versus $184.5 million in 1974; net increases in reserves were $11.9 million in 1975 versus $18.3 million in 1974; and reserves at year end in excess of the next two years' (1976-1977) bonded debt service were $23,866,000 in 1975 versus $23,570,000 in 1974, a difference of $296,000, not the approximately $27 million that appellees would have the Court believe was realized by the toll increases. This is not "creative accounting" (Ap. B. 32 fn. 21) but rather exactly the same distribution of income analysis as that set forth in the Stipulation Among Counsel.

This analysis shows beyond question that the toll increases were necessary to enable the Port Authority simply to maintain the status quo in the light of enormous increases in operating expenses. There is no windfall which can be diverted to deficit rail mass transit.

How can appellees say on one page of their brief that the Covenant's protection is "redundant" (Ap. B. 21) and on another (Ap. B. 59, 61) that only the Convenant prevents

diversion of hundreds of millions of pledged revenues and reserves to deficit rail mass transit? (A 528).

Appellees are also quick to misquote Mr. Thompson (compare his testimony at A. 961 with appellees' summary at Ap. B. 34) and to suggest that Mr. Thompson could not have relied on the Covenant because he had never analyzed a hypothesis which he described, quite fairly, as a "never-never land" (A. 945). Appellees say "[t]he point is important" (Ap. B. 34). The point is frivolous. Appellees set up a preposterous supposition, knock it down, and then conclude that since the Covenant would not prevent it the Covenant's protection was "modest" (Ap. B. 34)[12].

In another footnote appellees complain about Appellant's references to the deposition of its Executive Vice President and then say "nor did Appellant offer any of its purchase and sale records to show that the Covenant had any bearing on its transactions in Port Authority bonds." (Ap. B. 37 fn. 24). This is simply false. Appellant offered its memorandum of April 27, 1961, E 346, and this is what it said[13]:

> "The Port of New York Authority is offering $35,000,000 consolidated bonds maturing serially on March 1, 1962 through 1981 on May 3. These bonds will be an obligation of the Authority for the payment of which the full faith and credit of the Port of New York Authority are pledged.
>
> "There is some question as to the future marketability of Port bonds. At the present time, certain questions have developed regarding the scope of responsibilities of the Authority. Recent legislation by the State of New York provides for the acquisition of the Hudson and Manhattan Railroad Com-

12. Appellant has never conceded that the Covenant could be satisfied by a 10-year subsidy, as appellees suggest. The plain language of the Covenant—*"derived from or incidental to such facility"*—strongly indicates a contrary conclusion.

13. Appellees say that the trial court's exclusion of this evidence was "clearly proper". It was clearly improper. *See Interchemical Corp.* v. *Watson,* 145 F. Supp. 179 (D.C. Cir. 1956).

pany and the establishment of a World Trade Center in lower Manhattan. The act passed by the New York State Legislature provides for no limits on either the revenues or the General Reserve Fund balances for use in the Hudson and Manhattan Railroad acquisition. Without such a provision, the present security behind Port bonds is weakened to a considerable degree. It is prudent to assume that even with the acquisition by a capable group of administrators such as the Port Commissioners, the Hudson and Manhattan Railroad will operate at a deficit until some major improvement on use of this facility occurs.

"It is further disturbing to note that the Governor of the State of New York in his memorandum of approval leaves little doubt that it is his thinking and that of his advisers that no guarantee be given to the bondholders of Port Authority obligations. There is further indication that suggests the Governor is contemplating future additional acquisitions of other commuter railroads by the Port Authority. Towards this end, the memorandum includes a restatement of the Compact of 1921 regarding the Port Authority and its "full power and authority to purchase, construct, lease, and/or operate any terminal or transportation facility." While such an eventuality will probably take some years to become effective, one can give credence to this possibility and its impact upon credit and markets for bonds of the Port of New York Authority.

"It is possible to replace current holdings of the consolidated bonds with other good quality obligations bearing similar coupon rates and at similar yields. It has been determined that the policy of the Trust Company will be to review holdings of Port of New York Authority bonds. We will, therefore, not use any bonds of the new issue and you will be contacted within a few days regarding current holdings."

This was the reaction in 1961 of the agency's largest bondholder to Port Authority involvement in deficit rail

mass transit without limitation—the bonds were simply crossed off the approved list.

Appellees then conclude their footnote (Ap. B. 37 fn. 24) with a *partial* quotation of an April 4, 1974 Trust Company memorandum which stated *in part:* "Efforts to repeal the 1962 Covenant by legislative action should not be viewed with alarm." E. 454. But appellees do not quote the *immediately following* sentences of the memorandum, explaining *why* there should not be a wholesale liquidation of Port Authority holdings:

> "It is likely that bondholders will challenge the repeal measure in the courts, contending that the repeal of the 1962 covenant would violate provisions of the Federal Constitution. The Trust Company, as the trustee of the last two issues of the Authority's bonds, may be obligated, either in conjunction with a bondholders' group or unilaterally to challenge this repeal, if the repeal is legislated. The final outcome of the enforceability of the covenant will be determined in the courts. It is also possible that a separately secured class of bonds could be issued for additional mass transit operations, thus preventing the dilution of the revenues and reserves pledged to the existing obligations (Consolidated Bonds) of the Authority. According[ly], we do not suggest the sale of present holdings at this time."

Appellees discuss at length the continued 'A' rating accorded Port Authority Consolidated Bonds since repeal. (Ap. B. 37-40). The fact is, however, that neither Moody's nor Standard & Poor's have evaluated a Port Authority bond issue for mass transit purposes which would violate the provisions of the Covenant. Moody's took care to emphasize the tentative nature of its continued "A" rating in the very sentence of the report quoted by appellees *in part* at Ap. B. 39:

> "The Superior Court in New Jersey has upheld New Jersey legislation that repealed the 1962 covenant restricting Authority involvement in deficit

> mass transit operations. This decision is a matter of deep concern to bondholders generally, and the decision has been appealed. *The effect on the Authority cannot be determined at this time in absence of a definite plan for financing mass transit projects and facilities deemed to be non-self-sustaining. In the meantime,* earnings of the present facilities are good, reserves for debt service continue strong, and recent toll increases have further strengthened financial position at this time." A 484-485 (emphasis added).

The emphasized portion of the above quote was deleted by appellees in their reference to the Moody's report. (Ap. B. 39).

The market has made its own assessment of the worth of a Port Authority bond without the Covenant, even where the issuance was not for any additional mass transit purpose. In October, 1973 the Port Authority sold its last bond issue prior to repeal of the Covenant. The interest rate was 5½%. In July, 1976 the Port Authority went back to the market for the first time in over two and one-half years. Not one penny of the issue was intended for any mass transit purpose which would have been violative of the Covenant. Yet the interest rate required to sell the issue was 8.20% and the underwriters purchased the bonds at a $20 (per bond) discount, resulting in a net interest cost to the agency of 8.27%, or 2.77%, almost three points, higher than the previous issue.[14] *The Wall Street Journal's* explanation of the extraordinary high interest rate ("almost 15% for single persons earning about $26,000 or families making about $36,000" (A. 1123)), was as follows:

> " 'Large buyers have refused to touch the Authority's bonds ever since the New York and New Jersey legislatures several years ago repealed the 1962 covenant and thereby weakened the protection

14. More recently, the agency sold bonds, in a period of extremely low interest rates, at a coupon of 7%, or 1½% above the October, 1973 issue. The bid was 99.21, for a net interest cost of 7.0290%.

> afforded to bondholders,' a dealer remarked" A. 1123.

If appellees were correct in contending that "the Covenant was immaterial and that the Port Authority would net $40 million in new revenues" as a result of repeal then institutions should have been clamoring for the new bonds. They were not. Nor do appellees attempt to explain why, in their own words, Standard & Poor's expressed "concern about the effect of future Port Authority involvement in mass transit" (Ap. B. 39) or why Moody's said that the decisions in this case "are a matter of deep concern to bondholders generally" (Ap. B. 40). The rating agency axe has yet to fall, but the writing is on the wall for all to see—once the State begins its announced diversions of Port Authority revenues and bonds are issued to finance the new intrastate extensions the rating agencies will make their reassessment.

Appellees refer to *four* of the literally hundreds of reports by investment analysts during the period from the Covenant's enactment to its repeal, which reports did not discuss the Covenant, and concluded from this that the Covenant was "too unimportant to mention". They do not qualify this conclusion by any reference to P-1, P-2, P-7, P-10 or any of the hundreds of other investment reports which described the Covenant in detail and emphasized its importance to investors.

One has only to look at Appellant's charts (P-89, P-92, P-95) to see the damage to the secondary market for Port Authority bonds caused by the repeal. The trial court pointed out:

> "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 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" A. 111.

Appellees take issue with the trial court's conclusions, notwithstanding the total lack of any contradictory evidence offered by them. They make the flat statement that "[t]he secondary market for Port bonds was unaffected" by 1961 New York Legislation directing an H & M takeover without Covenant protection (Ap. B. 41), but they cite no expert testimony in support of this conclusion, since none was offered. As we know from the Farley Committee Report, the reason the market was not affected is that New Jersey refused to so endanger "the future utility of the Port Authority to the 2 states" (A. 654-655) and insisted that the Covenant be enacted. Appellees cite a Dun and Bradstreet report in 1962 rating the Port Authority's prospects as "Superior", in the face of bi-state legislation requiring a H & M takeover, but they do not quote the basic conclusions of the report, which condition the analysis on the adoption of the 1962 Covenant:

> ". . . The Authority is studying the possibility of acquiring and improving the Hudson & Manhattan Railroad Company. As noted, the Authority has no power to proceed with this project, or with the World Trade Center, without authorizing legislation from both states. The Authority has stated that upon due statutory authorization it might be able to sell bonds for such acquisition if investors could be given contractual assurance with statutory protection that its General Reserve Fund could not be

> applied to commuter rail transit deficits beyond those of the present and existing Hudson & Manhattan Railroad. It has specified additional protections necessary to insure financial soundness of the undertaking" (A. 176-177).

Appellees then cite the successful sales of Port Authority bonds while the Covenant was in effect as support for the Covenant's alleged immateriality, since investors supposedly were on notice that the Covenant "might or might not endure" (Ap. B. 41).[15] To say that this is contradicted by the record is an understatement (E.g., A. 861, 872, 873, 874, 875, 879, 921, 922, 939, 951, 980, 981).

Appellees then refer to the sales of the 40th and 41st series of consolidated bonds, sold in June and October, 1973, after the prospective repeal of the Covenant in May, 1973, as evidence that investors were willing to purchase consolidated bonds at reasonable interest rates even though the Covenant was not part of their bond contract. Appellees ignore the undisputed fact that the Covenant continued in effect with respect to outstanding consolidated bonds, which, by their terms, would not finally mature until 2007. Thus the Covenant remained binding in fact on the Port Authority. This was made clear by the agency in its Official Statements for the 40th and 41st series, each of which contained the following representation:

> "The statutory covenant against dissolution of pledged revenues and reserves by additional passenger railroad facilities, which is discussed in the paragraph quoted above, remains in effect with respect to affected bonds, and remains binding on the Authority although it does not apply to the bonds of the present offering."

15. In another footnote (Ap. B. 41 fn. 26) appellees suggest that Mr. Thompson was "aware at all relevant times that under certain circumstances a State may constitutionally abrogate its contracts and that other pledges had been repudiated". What Mr. Thompson actually said was:

> "Your Honor, a day or two ago, I read a brief prepared by someone on this subject which cited some cases pro and con

It was the uncontradicted testimony of Gordon Fowler that there was approximately $1,700,000,000 of Port Authority bonds outstanding and that it was "unreasonable to expect that these bonds would be fully retired in the immediate future or even the foreseeable future and therefore the 40th series bonds were indirectly protected by the Covenant" (A. 1105).

One has only to compare the last sale of bonds by the Port Authority before repeal of the Covenant, at a 5½% interest rate, with the first sale of bonds by the agency after repeal, at an interest cost to the Port Authority of 8.27%, to see the difference in evaluation by investors of bonds with the Covenant and bonds without it.

Appellees spend only two pages of their brief (Ap. B. 43-45) discussing the closing of the prices for Port Authority and comparable bonds in February of 1975. They do not attempt to contradict the testimony of Appellant's expert witnesses explaining the technical reasons for this closing. And the continuance of the closing after February, 1975 was due entirely to artificially low prices for Massachusetts Port Authority bonds (as a result of political threats in Massachusetts to the independence of that agency) and not to any reevaluation of the Port Authority's credit by investors. A. 446-476. This was dealt with at length by Appellant in its briefs before the New Jersey Supreme Court which are in the record.

The Reasons for the Repeal of the 1962 Covenant.

Appellees would have this Court believe that all of the Legislative history which preceded the adoption of the

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and came to the conclusion that this case was in the class of those where the police power would not prevail" (A. 951).

Shortly thereafter he said: "Well, there have been other repudiations of solemn pledges granted. Some of them have been taken to Court and beaten down too" (A. 952).

prospective repeal in 1973 also formed the basis for the retroactive repeal in 1974. To disprove this contention, it is necessary only to stop the clock for a moment on October 1, 1973. On that date, the Port Authority successfully sold $100 million of consolidated bonds at an interest rate of 5½%, which was ½% lower than its previous sale in June, 1973. Investors were well aware (1) that the Covenant had been reconsidered by both legislatures over the course of the preceding year; (2) that both legislatures, after such reconsideration, repealed the Covenant only prospectively, expressly maintaining in effect the Covenant's protection with respect to outstanding affected bonds and the Covenant's indirect protection in fact for future issues of consolidated bonds; (3) that the legislation embodying the Covenant had been upheld by this Court and by the highest court in New York (*Courtesy Sandwich Shop* v. *Port of N.Y. Authority,* 12 N.Y. 2d 379, *appeal dismissed,* 375 U.S. 78, *reh.* denied, 375 U.S. 960 (1963)); (4) that the Covenant itself had been upheld in federal court (*Kheel* v. *Port of New York Authority,* 331 F.Supp. 118 (S.D.N.Y. 1971), *aff'd on other grounds,* 457 F.2d 46 (2nd Cir. 1972); *cert. denied,* 409 U.S. 983 (1973)); and (5) that the Port Authority, with the approval of the States, was defending the Covenant in the New Jersey Superior Court (*Gaby* v. *The Port of New York Authority*). As a result of this history of litigation and the express legislative reaffirmation of the Covenant by the legislatures of both States, after exhaustive study and consideration, the Covenant, more than at any time in its history, was presented to investors as a solemn, binding obligation of both States intended to endure so long as affected bonds remained outstanding. A few months later, with the new administration in New Jersey, the Covenant was retroactively repealed.

Appellees discuss at length the energy crisis (Ap. B. 46-50), health and environmental factors, (Ap. B. 50-52), and the Port District's public transportation requirements (Ap.

B. 53-60). They cite the "post-repeal plans" for financing mass transit, saying again at Ap. B. 60, 61 and 62 that the toll increases are generating $40 million in new revenue annually.

No one disputes that there was an energy crisis in the winter of 1974, that the environment should be improved or that more and more efficient mass transit is desirable. What is disputed, and which was disputed in 1961, is (1) whether these problems constitute such "emergencies" in the eyes of the law, as to justify the use of the States' police power to abrogate its solemn promise to its citizens, upon which its citizens relied, and (2) the extent of involvement in a perpetual deficit activity by a revenue bond agency dependent for its survival on private funds contributed by private investors who, in good faith, relied upon the security provisions promised to them by the agency and the States.

The Constitutionality of Repeal.

We submit that the key to the constitutional validity of the retroactive repeal of the 1962 Covenant is set forth in the Official Statement recently distributed by the Port Authority in connection with the issuance of the Forty-Third series of consolidated bonds. In describing the proposed extension of PATH to Plainfield the Statement says in part:

> "The Port Authority has undertaken active preparations to carry out the statutory programs. In May, 1975, it filed an application with the Urban Mass Transportation Administration of the U. S. Department of Transportation (UMTA) for $277,600,000 to pay part of the cost of extending the PATH system to Plainfield. It is contemplated that the Port Authority Trans-Hudson Corporation (PATH) would enter into an agreement with the State of New Jersey or a subsidiary corporation of the State under which PATH would acquire all

> necessary real and personal property out of the proceeds of future issues of Port Authority bonds and UMTA grants, and lease said property to the State or its subsidiary. *The amount of rent to be paid by the State would depend primarily on the outcome of the litigation relating to the repeal of the statutory covenant (see "Litigation", pp. 20-22). That litigation will affect the extent to which the project or the State must cover debt service on the Port Authority's bonds issued for the project.*" (Emphasis added.)

In other words, if the retroactive repeal of the 1962 Covenant is upheld, the Port Authority will be required by the State to divert pledged revenues from other facilities to the payment of debt service on the bonds issued to finance the PATH extension. If, however, the retroactive repeal of the Covenant is declared unconstitutional the State of New Jersey will simply increase its rental payments by an amount sufficient to cover debt service. This case does not involve energy or health or the environment or any other "emergency." It involves money, and only money; a scheme by politicians to shift the burden of financing public purpose projects from the State to an independently financed public agency.

At the very outset of their legal argument appellees completely misstate Appellant's argument and then complain that Appellant has reversed its position on appeal:

> "[A]ppellant chooses to deny here a proposition it conceded below: that State contracts are subject to legislative action under the State's police power" (Ap. B. 63).

This is simply not what Appellant said in its brief. Rather, Appellant's position is:

> "A State is competent to conclude contracts secure against any impairment by subsequent legislative action, even action taken under the guise of the

> State's police power. '[T]he right to make binding obligations is a competence attaching to sovereignty.' *Perry* v. *United States,* 294 U.S. 330, 353 (1935). The 1962 statutory Covenant here in issue, a solemn undertaking between a State and its creditors, is a classic example of a contract secure against impairment. (A.B. 48)
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> * * *
>
> "On occasion, contracts through judicial interpretation have been found to be subject to subsequent legislative impairment as a proper exercise of a State's police powers. But where, as here, the contract is between the States and creditors of the State agency, it is settled that the States may not thereafter act in derogation of their solemn undertaking." (A.B. 50)

Having thus misstated Appellant's position, appellees attack the straw man they have set up and effectively argue the point which Appellant concedes is the law: that on occasion some State contracts, not involving a third-party loan to a State or its agency, have been held subject to reasonable *modification* (but never outright cancellation, as in the present case) where found to be a reasonable exercise of the police power. We agree. See Ap. B. 65-72. And appellees concede the basis tenet of Appellant's case:

> "This is not to say that one legislature can never bind the next, for plainly it can to some extent despite the general presumption against such a construction" (Ap. B. 68).

Assuming as both sides now do that a Legislature is possessed of competence as a sovereign to enter into binding contracts one cannot present a more compelling set of circumstances for such a conclusion than the present case. This case does not involve changing the county seat (*Newton* v. *Board of County Commissioners,* 100 U.S. 548

(1880)), or repealing a lottery franchise (*Stone* v. *Mississippi,* 101 U.S. 814 (1880)), or repeal of a butchers' monopoly (*Butchers' Union Co.* v. *Crescent City Co.,* 111 U.S. 746 (1884)). Rather it involves who should pay for intrastate rail mass transit deficits: the state or the bondholders of an agency charged with interstate freight responsibilities.

Appellees do not attempt to distinguish the cases cited by Appellant to support its position that the contract here in question is not subject to legislative abrogation. Rather they say that *Wolff*[16] and *Louisiana* v. *Pilsbury*[17] did not survive *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502 (1942). Far from overruling *Wolff and Louisiana* v. *Pilsbury,* the Court in *Faitoute* did not even cite them.

Continuing their argument that the Covenant was subject to cancellation without notice, appellees say:

> "The covenant did not state that it was immune from the police power and its silence on this point should itself be dispositive." (Ap. B. 74).

This silence is hardly dispositive. The principal legislative history of the Covenant, the Farley Committee report, specifically described the Covenant as "constitutionally protected". It was sold to investors as secure against change, and independent bond counsel so opined a mere two years before its abrupt cancellation (A. 692). Appellees say in a footnote (Ap. B. 75) that "all contracts are constitutionally protected" but that Appellant misunderstands the scope of this protection, *i.e.,* that it is nonexistent. Appellees quote from the superior court opinion which in turn quoted from Senator Farley who said "one

16. *Wolff* v. *City of New Orleans,* 103 U.S. 358 (1880).

17. 105 U.S. 278 (1881).

Legislature cannot bind a subsequent Legislature involving policy," (A. 88), but they do not complete the colloquy, which concluded:

> "Q. It seems to me on that basis, that you enter a contract on the basis of legislation passed, that contract is going to stand and some later legislature is not going to be able to change it. A. That's right" (A. 88).

Thus, having misstated Appellant's position, having urged that two cases were overruled by a case which did not even cite them, and having quoted half of a colloquy which concluded that the Covenant was not subject to future cancellation, appellees reach the conclusion that the Covenant was cancellable at the whim of a change in administrations—a conclusion that flies in the face of the facts. The Covenant by its very terms was to endure "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." Nevertheless appellees argue (Ap. B. 76) that since the Covenant was subject to change without notice, no one could have relied on it, even though the superior court reached exactly the opposite conclusion, expressly holding that bondholders did rely (A. 110). If in fact any credible investor or municipal bond analyst agreed with appellees' view of the case why were they not called to testify at trial?

Appellees repeat that the only "essential obligation" entitled to constitutional protection in a bond contract is the simple promise to pay principal and interest (Ap. B. 79), implying that all other covenants, regardless of their importance as security devices, are subject to cancellation if a majority of the Legislature decides to do so under some vague and ill-defined notion of the police power. Appellees

would reduce all municipal obligations to unsecured term notes for purposes of investor analysis.

Appellees cite *New Jersey Sports & Exposition Authority* v. *McCrane*, 61 N.J. 1, *appeal dismissed*, 409 U.S. 943 (1972) as a case which clearly put bondholders on notice that the authority's bonds were subject to change without notice. There was in fact one passing reference to the police power, but this is what the court said about the exercise of that power:

> "The principles applied in Sills are equally applicable here, and it may be stated definitively that the bonds of the Authority in the hands of purchasers constitute valid contracts binding on the State according to their terms, and are entitled to the same constitutional protection against impairment at the hands of subsequent Legislatures as are the bonds of the Educational Facilities Authority, N.J.S.A. 18A:72A-10, 19, of the New Jersey Mortgage Finance Agency, N.J.S.A. 17:1B-10(g), 17, and of any other similarly constituted agency created for the performance of a public purpose whose bonds are supported by a like pledge of the State. Moreover, aside from the strict applicability of constitutional principles, having in mind our form of government, we believe the integrity of the legislative branch to be such that a succeeding Legislature would not undertake to impair in any material fashion a solemn pledge made in good faith to bondholders by a predecessor Legislature." *Id.* at 29.

The Weintraub court's faith in the legislature was as misplaced as investors'.

To appellees repeal of the Covenant was "obviously an exercise of the police power . . ." (Ap. B. 81). To investors, repeal was just as obviously the fulfillment of a campaign pledge by a politician. Appellees discuss health, and environmental, and energy factors as though quoting from some detailed legislative history of repeal. No such history

exists. No hearings were held, no notice was given, no findings of fact were made. The Governor of New York said in effect that repeal was tragic, not some noble exercise of the police power. That there were energy problems and environmental problems and health problems at the time of repeal is not disputed. That they had any causal connection with repeal is an after-the-fact fabrication—a lawyer's brief, not legislative history.

Appellees' stated position is that for an exercise of the police power (i) no findings of fact or declarations of emergency are necessary (Ap. B. 81) and (ii) no emergency or declaration thereof need exist (Ap. B. 82). This argument is understandable, since if any emergency did prompt the repeal, it was not one of such importance that Governor Byrne thought to mention it in his message approving repeal. (A. 776-777).

Appellees discuss at length the Court's decisions in *Blaisdell* and *El Paso* (Ap. B. 83-88) but they are unwilling to have the case tested by the guidelines enunciated in *El Paso* (Ap. B. 88 fn. 56)—even though these are the very guidelines appellees say the lower courts should apply in contract clause adjudication.

Appellees conclude that no one understood the Covenant, that it was superfluous and redundant, and then say that only by repeal can hundreds of millions of pledged revenues and reserves be diverted to deficit rail mass transit.[18]

Appellees take issue again with Appellant's statement that: "no one disputes" that anything repeal can do the States can do "to the same extent" by putting up their own

18. Appellees conclude, without record citation or support, that "[o]btaining bondholder approval would be impossibly burdensome" (Ap. B. 97), but this is exactly what the Covenant contemplated, and there has been no legislative finding that approval would be difficult. Appellant, for example, holds almost $100 million of Consolidated Bonds, and until repeal institutional investors were the largest purchasers of Port Authority obligations.

money (Ap. B. 98). Yet appellees do not mention the only project to yet result from repeal (the PATH extension) and point out that the only effect which this litigation will have is to determine the amount of rent to be paid by the State.

The Constitutional Validity of the 1962 Covenant

Appellees had the candor in the New Jersey Supreme Court to label their arguments with respect to the constitutional validity of the Covenant as a cross-appeal from the superior court's decision, since the superior court did not pass on the point. They did not appeal to this Court but have simply relabeled their arguments and in effect seek to cross-appeal in their brief.[19] Viewing appellees' claims with respect to the constitutional validity of the Covenant in the same way that they viewed them in the courts below, this Court has already determined that it is without jurisdiction to hear their cross-appeal. *Gaby* v. *The Port of New York Authority,* 44 U.S.L.W. 3747 (1976)[20].

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19. In appellees' New Jersey Supreme Court brief they followed the first paragraph on page 103 of their brief in this Court with the following statement: "Judge Gelman dismissed this *defense* because, having upheld the repeal legislation, he did not have to decide it. *We have appealed* because the Covenant's invalidity offers an alternative basis for upholding the constitutionality of repeal and for resolving the New York question discussed in Point V, *infra.* (At pp. 81-82.) (Emphasis added.)

20. Appellant dealt with the merits of the consent issue in its Motion to Dismiss Appeal in *Gaby* v. *The Port of New York Authority* dated June 7, 1976. The issue of superseding Federal law is frivolous; while appellees mention many acts of Congress, they cannot point to any statutory language which indicates, even indirectly, a Congressional desire to compel State action in the field of rail passenger transit. And even if they could the Covenant clearly effected the first financial involvement of the agency in deficit rail mass transit; it did not obstruct it.

CONCLUSION

The decision of the superior court should be reversed and the declaratory judgment sought by the Trust Company should be granted. The 1974 Legislation contravenes the Contract Clause of the United States Constitution and is a taking of bondholders' property without compensation in violation of the Due Process Clause. Chapter 25 of the Laws of New Jersey of 1974 is void.

Respectfully submitted,

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