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# **FREEDOM OF CONTRACT**

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**George Mason University Law and Economics  
Research Paper Series**

**08-51**

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## *Freedom of Contract*

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The contract clause, found in Article I, section 10 of the Constitution, prohibits the states from impairing the obligations of contracts. This clause had the potential to be the foundation of a general right to freedom of contract, but the Supreme Court held in *Ogden v. Saunders*, 25 U.S. 213 (1827), that the clause applies only to retroactive impairments of existing contracts, not to general police power regulation that affects future contracts. Starting in the New Deal period, the Supreme Court further restricted the scope of the clause, and today it is rarely invoked to limit states' interference with contracts.

### *Early Court Interpretation*

While the contract clause never fulfilled its potential of protecting a general right to freedom of contract, by the late nineteenth century American courts began to assert that a right to contract free from unreasonable government regulations is protected by the due process clause of the Fourteenth Amendment. The first indications that the Supreme Court might be sympathetic to such a right are found in the dissents in the *Slaughter-house Cases*, 83 U.S. 36 (1873), by Justices Joseph Bradley and Stephen Field. Both dissents argued that the Fourteenth Amendment protects the right to pursue an occupation free from unreasonable government interference. Dissenting in *Powell v. Pennsylvania*, 127 U.S. 678 (1888), Field argued that the liberty protected by the due process clause includes “the right of man to be free in the enjoyment of the faculties with which he has been endowed by his Creator, subject only to such restraints as are necessary for the common welfare.”

By the early 1890s, several state courts had held that liberty of contract was constitutionally mandated. Some legal commentators harshly criticized these opinions, whereas others opined that maximum hours laws, truck acts, laws requiring payment of wages at certain intervals, and other laws intended to protect workers all violated the right to liberty of contract.

The Supreme Court gradually accepted the notion that liberty of contract was an enforceable constitutional right under the due process clause. In *Frisbie v. United States*, 157 U.S. 160 (1895), the Court, speaking through Justice David Brewer, offhandedly declared that “generally speaking, among the inalienable rights of the citizen is that of the liberty of contract.” In *Allgeyer v. Louisiana*, 165 U.S. 578 (1897), the Court for the first time invalidated a state law as a violation of liberty of contract. The Court held that Louisiana violated the due process clause when it penalized a domestic company for contracting for maritime insurance with a New York company.

Justice Rufus Peckham (1809–1873), writing for the Court in *Allgeyer*, favorably cited Bradley’s dissent in *Slaughter-house*. He also quoted Justice John Marshall Harlan’s majority opinion in *Powell*. Though *Powell* upheld restrictions on the sale of margarine, Harlan recognized a Fourteenth Amendment right to “enjoyment upon terms of equality with all others in similar circumstances of the privilege of pursuing an ordinary calling or trade, and of acquiring, holding and selling property, as an essential part of [the] rights of liberty and property.” Neither of these previous opinions had suggested that the Constitution protects a general right to liberty of contract, but Peckham’s opinion in *Allgeyer* firmly established liberty of contract as a right protected by the Fourteenth Amendment’s due process clause.

However, just a year later, in *Holden v. Hardy*, 169 U.S. 366 (1898), a seven-to-two majority of the Court placed significant restrictions on the scope of the liberty of contract

doctrine. In the process of upholding a maximum hours law that applied only to underground miners, the Court declared that reasonable health or safety measures were within the states' police powers, even if they interfered with freedom of contract. The Court also suggested that it should generally defer to the state's view that it is operating within its police power. A series of Court decisions upholding various labor regulations followed, with only Justices Brewer and Peckham regularly dissenting.

Much to almost everyone's surprise, a five-to-four majority of the Court applied the liberty of contract doctrine to invalidate a New York maximum hours law for bakers in the notorious case of *Lochner v. New York*, 198 U.S. 45 (1905). In an opinion by Justice Peckham, the Court held that in the absence of evidence that the hours law protected public health, or that baking (like mining in *Holden*) was an especially unhealthful field in need of specific regulation, the law was an unjustified interference with liberty of contract. In dissent Justice Harlan, writing for himself and two others, agreed that the Constitution protected liberty of contract. He argued, however, that the hours law was a valid police power measure. Only Justice Oliver W. Holmes's famous lone dissent rejected the liberty of contract doctrine.

Labor activists and Progressive legal scholars were outraged by *Lochner*. They accused the Court of serving as a tool of capital and of engaging in mechanical jurisprudence. With justification, many early *Lochner* critics noted the Court had turned the traditional Anglo-American hostility to monopoly power, as expressed in the *Slaughter-house* dissents, into the much broader doctrine of liberty of contract.

Despite all of this ferment, for almost two decades *Lochner* turned out to be an aberration, with *Holden*'s apparently more liberal interpretation of the scope of the police power holding sway. That's not to say that the Court never held that laws violated the right to liberty of

contract. Following *Lochner*, in *Adair v. United States*, 208 U.S. 161 (1908), and *Coppage v. Kansas*, 236 U.S. 1 (1915), the Court invalidated laws prohibiting so-called yellow-dog contracts, contracts that prohibited employees from joining labor unions. In *Buchanan v. Warley*, 245 U.S. 60 (1917), the Court unanimously invalidated a Louisville law prohibiting individuals of one race from buying a house on a block populated mostly by those of a different race.

The most controversial issue of the day, however, was the status of labor reform, and at least through the early 1920s the Court rarely interfered with labor or health regulations claimed to be within the states's police power. In the decade after *Lochner*, the Court upheld almost every state labor reform law that came before it, including laws banning child labor; regulating the hours of labor of women employees; making mining companies liable for their willful failure to furnish a reasonably safe place for workers; mandating an eight-hour day for federal workers or employees of federal contractors; and many others.

By 1917, the liberty of contract doctrine seemed virtually moribund. The Court upheld four very controversial labor reforms: workers' compensation laws, a federal law that not only limited railroad workers to an eight-hour day but also fixed wages at the level the workers had received when working longer hours, a minimum wage law for women, and a maximum hours law for all industrial workers.

### *1920s Resurgence*

Liberty of contract, however, underwent a surprising renaissance in the 1920s, after President Warren Harding (1865–1923) appointed four new conservative justices to the Court, led by Chief Justice William Howard Taft. Instead of continuing to rule case by case, the Court formalized and froze various doctrinal exceptions to liberty of contract, such as the government's virtual *carte blanche* to regulate businesses "affected with a public interest." *Munn v. Illinois*, 94

U.S. 113 (1876). These exceptions left a reasonably broad scope for liberty of contract.

In *Adkins v. Children's Hospital*, 261 U.S. 525 (1923), a five-to-three majority of the Court invalidated a minimum wage law for women. The *Adkins* Court announced that “freedom of contract is...the general rule and restraint the exception; and the exercise of legislative authority to abridge it can be justified only by the existence of exceptional circumstances.” The Court acknowledged that government regulation could be used for traditional police power purposes. Beyond that, the Court asserted that precedent limited interference with liberty of contract in the labor context to cases involving the following issues:

- (1) “those dealing with statutes fixing rates and charges to be exacted by businesses impressed with a public interest.”<
- (2) “statutes relating to contracts for the performance of public work.”
- (3) “statutes prescribing the character, methods and time for payment of wages
- (4) “statutes fixing hours of labor” to preserve the health and safety for workers or the public at large.

Thus, during the Taft Court era the exceptions to liberty of contract created by prior Court decisions were retained, but they were categorized and applied narrowly to prevent what the Court saw as further erosion of individual liberty.

It was only after *Adkins* that *Lochner's* vigorous protection of freedom of contract was no longer an anomaly. The next decade or so marked the Court's most aggressive consistent enforcement of freedom of contract. The Court, for example, invalidated a law regulating the size of bread loaves (*Jay Burns Baking v. Bryan*, 264 U.S. 504 [1924]), and a law establishing an ice monopoly in Oklahoma (*New State Ice v. Liebmann*, 285 U.S. 262 [1932]). The Court also expanded its protection of liberty of contract to include private school attendance (*Pierce v.*

*Society of Sisters*, 268 U.S. 510 [1925]), and foreign language instruction (*Meyer v. Nebraska*, 262 U.S. 390 [1923]), threatened by nativist legislation. Even so, the Court upheld most of the laws that came before it, including such far-reaching interferences with freedom of contract as exclusionary zoning (*Euclid v. Ambler Realty*, 272 U.S. 365 [1926]), and broad regulation of the railroad labor market (*Texas & New Orleans Railroad v. Brotherhood of Railway and Steamship Clerks*, 281 U.S. 548 [1930]).

Meanwhile, the Court's liberty of contract jurisprudence rested on a tenuous intellectual foundation. By the 1920s libertarian views, especially on economics, had already been marginalized among American intellectuals and retained only a vestigial foothold among traditionalist elements in the legal community. The Great Depression eroded remaining support for liberty of contract. The Supreme Court's commitment to private ordering in the economic sphere seemed outlandishly reactionary and insensitive to much of the public. The Court's implicit belief that libertarian presumptions were fundamental to Anglo-American liberty and that liberty of contract was thus protected by the due process clause became untenable as the Depression wore on, with many Americans blaming the purported laissez-faire policies of previous administrations for the continuing economic crisis.

### *Shift on the Court*

Despite the shift in the intellectual tides, the Court's advocates of liberty of contract held fast to their views, and Court doctrine shifted only with changes in personnel. True to his essentially Progressive Republican nature, President Herbert Hoover (1874–1964) appointed three skeptics of freedom of contract to the Court—Justices Charles E. Hughes, Owen Roberts (1875–1955), and Benjamin N. Cardozo. By 1934, a majority had formed willing to broadly expand the “affected with a public interest” doctrine to the point where just about any regulation

of prices was constitutional. In that year, the Court upheld a New York law fixing the price of milk, defining “affected with a public interest” as meaning no more than “subject to the exercise of the police power,” which includes all businesses (*Nebbia v. New York*, 291 U.S. 502 [1934]).

In *West Coast Hotel v. Parrish*, 300 U.S. 379 (1937), the Court reversed *Adkins* and upheld a minimum wage law for women. The Court argued that liberty of contract was merely a subset of liberty and could be abrogated in the public interest, as other Supreme Court precedents over the previous forty years had shown. Given economic conditions during the Depression, the Court could not say it was unreasonable for a state legislature to try to guarantee women workers in general a living wage, even if the statutory means chosen harmed workers who could not command the minimum. The Court suggested that it was returning to the reasoning of opinions such as *Holden* and Harlan’s dissent in *Lochner*, not abandoning constitutional protection of freedom of contract entirely.

However, President Franklin D. Roosevelt shifted the center of gravity of the Court with a series of appointments, and the Court soon declared that economic legislation that allegedly violated freedom of contract was subject only to minimal constitutional scrutiny, to ensure that challenged legislation had a rational basis. Under this standard, the Court upheld a series of measures that would clearly have been unconstitutional under the prior regime, such as the National Labor Relations Act (*United States v. Darby*, 312 U.S. 100 [1941]).

As New Deal liberals came to dominate the Court, even the rational basis test, applied literally, seemed too stringent. In *Williamson v. Lee Optical of Oklahoma*, 348 U.S. 483 (1955), the Court faced a challenge to legislation requiring that an optician may not fit or duplicate lenses without a prescription from an ophthalmologist or optometrist. Under this law, without a prescription an optician could not even sell a pair of replacement frames to someone whose

frames broke. The Court held that it did not matter if the law's requirements were in fact rationally related to its stated objectives or to the objectives asserted by the state in its briefs before the Court. Rather, so long as it "might be thought that the particular legislative measure was a rational way to correct" a problem, a law was constitutional. A hypothetical rationale, in other words, never even considered by the legislature that passed the law or argued to a court, was sufficient to render a law nonarbitrary and constitutional.

In *Ferguson v. Skrupa*, 372 U.S. 726 (1963), a unanimous Court went even further, and suggested that not even the *Williamson's* extremely forgiving rational basis test need be satisfied because the Fourteenth Amendment provides no protection at all for freedom of contract. The Court stated that "it is now settled that the states have power to legislate against what are found to be injurious practices in their internal commercial and business affairs, so long as their laws do not run afoul of some specific federal constitutional prohibition."

Despite these decisions, lower federal courts will occasionally hold that a law that restricts freedom to pursue an occupation is so clearly arbitrary or unreasonable as to fail the rational basis test. For example, in *Craigmiles v. Giles*, 312 F.3d 220 (6th Cir. 2002), the Sixth Circuit held that a law that allowed only licensed funeral directors to sell caskets violated the due process clause. Some state courts, meanwhile, never retreated as far from *Lochner* as the Supreme Court did, and still occasionally invalidate economic regulations that go too far in restricting economic freedom as violations of their states' constitutions. In general, however, freedom of contract is almost entirely unprotected under modern constitutional law.

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