The COVID-19 Crisis and Lessons from Kentucky’s
“Old Court-New Court Controversy”

Kurt X. Metzmeier

As measures by states to reduce the impact of the coronavirus on lives and in its impact on the economy become more unprecedented, it is inevitable that they are running into certain constitutional barriers to the power of government to restrict the activities of business. In Kentucky (and many other states), courts suspended evictions, which in Kentucky was followed by Governor Andy Beshear’s Executive Order 2020-257 on March 25, 2020 extending this to the whole state. The measure was clearly designed to prevent the spread of the disease, but other emergency measures are more designed to buffer economic damage to businesses.

In New York, foreclosures and mortgage payments have been suspended for 90 days, although the payments will be eventually paid. Similar halts to foreclosures followed in Florida and California. On March 18, HUD and the Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, suspended foreclosures and evictions for “at least 60 days.” In states without such acts, the closing of courts to non-essential business has had similar effect.

Congress and legislatures are now considering measures to let small businesses activate business interruption clauses in their insurance contracts to nullify insurance clauses excluding pandemics from the business interruption clauses of existing policies. One proposed measure to mitigate the economic damage of the novel coronavirus appears to directly implicate the ability of private parties to contract without government interference. States like New Jersey, Ohio, Massachusetts and New York are considering legislation to retroactively alter insurance contracts by nullifying clauses excluding pandemics from the business interruption clauses of existing policies

Police Power and its Limits

The ability of governors to issue emergency orders derives from an ancient common law authority, the so-called “police powers” of state governments to regulate activities and enforce order for the public health, safety and general welfare of their residents. It is one of the most important powers reserved to the states by the Tenth Amendment to the U.S. Constitution. United States v. Dewitt, 76 U.S. 41, 45 (1869).

It was explained by America’s most influential jurist, Massachusetts’ Lemuel Shaw in Commonwealth v. Alger, 61 Mass. 53 (1855): “We think it is a settled principle, growing out of the nature of well-ordered civil society, that every holder of property, however absolute and unqualified may be his title, holds it under the implied liability that his use of it may be so regulated that it shall not be injurious to the rights of the community.” (Punctuation modernized)

Shaw goes on to say that “it is much easier to perceive and realize the existence and sources of this power, than to mark its boundaries, or prescribe limits to its exercise.” However, he clearly indicated, and other courts have followed, that the state’s exercise of this power must be “reasonable.”

Shaw references smallpox measures and indeed legal precedents are unanimous in upholding the exercise of the police power during public health and safety emergencies, which is perhaps the height of its potency. Kentucky adopted Shaw’s opinion in Sanders v. Commonwealth, 17 Ky. 1, 5 (1803), quoting the same language quoted above, and they exercised it to protect the commonwealth from pestilences endemic to the state, including smallpox, yellow fever, influenza, and, with urbanization, venereal diseases.

In Henghold v. City of Covington, 57 S.W. 495 (1900), the Kentucky courts approved the removal of children to a “pest house” (a quaint term for an infectious disease hospital). In Duncan v. City of Lexington, 244 S.W. 60 (1922), a reputed prostitute was arrested and confined indefinitely for allegedly spreading syphilis. When a milliner in Kuttawa was accused of spreading smallpox through clothing sold in her store, the court denied her compensation for the destruction of the store’s contents during its fumigation. Allison v. Cash, 245 S.W. 245 (1921).

Purely economic measures to prevent damage to the general welfare, especially during economic depressions, are a valid exercise of the police power and, indeed the issue in Alger involved a zoning regulation. But courts have found more limits than reasonability, including due process and the takings clause of the Eighth Amendment.

And, of course, the contract clause.

The Contract Clause and Kentucky’s Court Controversy of the 1820s

Interestingly, this is not the first national crisis where state legislatures have tried to relieve the harshest impact of unforeseen financial emergencies. In the late 1820s in Kentucky debt relief measures rolled the states politics, split the state’s courts, and left the Commonwealth economically depressed for a decade. As I describe in my 2016 book, Writing the Legal Record: Law Reporters in Nineteenth-Century Kentucky, when the international “global economy shaped by the Napoleonic Wars hurchéd into peace,” gold—the standard of all banking—flowed back to the recovering victors. This created monetary dislocations in the American financial system that sparked the Panic of 1819. In Kentucky, the lack of hard currency—gold being very hard to transport to the frontier—meant that unregulated bank notes provided the liquidity necessary for growth.

What “passed for economic wisdom in that era” prompted the National Bank to call in debts from poorly capitalized local banks. This started a “chain reaction of collapsing private and state banks and legal proceedings against farmers to force them to pay back bank loans.” Creditors began proceedings to foreclose on the property of debtors, leading to cries for debt relief. In August 1820, pro-relief candidates in Kentucky won control of the lower house of the General Assembly and began to devise methods to do this.

George M. Albright, a former chief justice of the Court of Appeals and a brilliant legal scholar, was among the relief faction leaders. The pro-relief legislature “passed two radical laws that, working together, gave debtors comprehensive relief while largely extinguishing creditors’ hopes that they would ever be paid.” They first chartered the Bank of the Commonwealth

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which was empowered to print banknotes to act as legal tender in the state. Because the new bank was poorly capitalized, the value of its notes was questionable.

In December, the legislature passed the Replevin Act, which mandated a two-year moratorium before a creditor could execute on a debt, unless the creditor agreed to be paid in the dubious notes of the Bank of the Commonwealth. The Replevin Act was an early legal action to attach and execute on property used to secure a loan.) Bibb and other drafters understood that the contract clauses in the U.S. and state constitutions would bar any explicit forgiveness of private debts. They "attempted to avoid that issue by focusing not on the debt obligation (which they admitted was constitutionally protected) but on the governmental procedures a creditor had to resort to in order to recover on that debt!" The argument had some merit, because the government not only opens the courthouse door to private creditors, it also creates statutory procedures to execute on debts in summary processes that are quicker and more efficient than in a normal contract case. (The same theory applies to evictions, the result of another summary proceeding.) However, the relief-party had gone much farther. Given the "excessive length of the moratorium—two years is a lifetime in a financial crisis—and the fact that the commercial paper of the Bank of the Commonwealth was widely considered worthless," creditors were right to argue that the laws were a legal maneuver to "wipe the debts from the books.

That's what the Court of Appeals ruled in the combined 1823 case of Blair v. Williams and Lapsey v. Brashers (4 Ky. 47), deciding by a 2–1 vote that the Replevin Act was an unconstitutional impairment of the right of contract. However, the relief faction still had some sting, and soon voted to abolish Kentucky's Court of Appeals and create a new high court, with new judges. This led to almost two years of the state having two high courts, a situation that was only resolved when the "Old Court party" recaptured the legislature in 1826, sending the New Court to the dustbins of history.

The Great Depression and The General Welfare

Nonetheless, the idea that, in tough times, states could pause or slow its statutory or court procedures for summary proceedings to give debtors more time to recover still has merit, so long as contract obligations are not extinguished. Indeed, modest moratoriums on the collection of debts were enacted by states during the Great Depression and were even considered by some state legislatures in 2008 after the collapse of the subprime mortgage industry.

Indeed, in 1934 the Supreme Court decided a Depression-era case involving a Minnesota law that "declared the existence of an emergency demanding an exercise of the police power for the protection of the public" by temporarily delaying the foreclosures and sale of defaulting mortgages. The court upheld the law, finding that the "contract clause must be construed in harmony with the reserved power of the State to safeguard the vital interests of her people," and noting the depth of the economic emergency and provisional nature of the restraint. Home Building & Loan Association v. Blaisdell, 290 U.S. 398 (1934). Given the times, this case might be an outlier. Nonetheless, it is important to note that the "reserved power" the court referenced was the "police power" of states to protect the general welfare of its citizens.

Drawing Conclusions for the COVID-19 Crisis

So, what are the lessons of history for the COVID-19 crisis regarding the rights of states to enact emergency measures that directly or indirectly affect contracts?

The first is that while states retain the police power to protect the public health and welfare that is reserved to it by the Seventh Amendment, the precedents suggest that the police power is at its apex when protecting the public health. Yet Blaisdell also instructs that it can be employed judiciously to protect the financial welfare of its citizens. However, when any of these measures invade the private agreements inscribed in mortgage, leasing and insurance contracts, the contract clause is implicated.

In cases when private rights must be executed through public courts using court procedures, the state has the right to change, delay and suspend those proceedings for the safety of its officers and for the public health and general welfare.

All these interests and rights must be balanced. No constitutional right is absolute, and no public power can be exercised unreasonably or capriciously.

The major lesson of the relief controversy in Kentucky was that no measure to alter the legal procedure is reasonable if its practical effect is to extinguish one party's commitments under a contract. In an economic crisis, suspending foreclosure for two years affects only bankrupts creditors while giving the debtors the benefits of the contract with none of the obligations.

In the Blaisdell case, the federal contract clause can be balanced against short halts to public executions of mortgage contracts so long as they are reasonable and protect the general welfare of the citizens.

Finally, it seems clear that measures during the COVID-19 crisis designed to protect lives strongly tilt the balance of equities towards the state's exercise of police powers. States protecting the economic welfare, however, must carefully balance those measures to not choose sides between parties to a commercial contract. Any government actions that have the effect of both protecting the public health and the economic welfare may well survive any contract clause challenges in the courts.

It is the job of governments and legislatures to balance these interests and rights so that the public's health and welfare is protected without unduly harming the contractual relations of its citizens.

Kurt X. Metzmeier is the associate director of the law library and professor of legal bibliography at the University of Louisville Brandeis School of Law. He is the author of Writing the Legal Record. Law Reporters in Nineteenth-Century Kentucky, a group biography of Kentucky's earliest law reporters, in 2019 were leading members of antebellum Kentucky's legal and political worlds.

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Summer Law Institute Cancelled

The Summer Law Institute—a week-long residential “law camp” for high school students interested in legal careers—has been cancelled out of concern for the safety and well-being of participants, volunteers and staff. While we regret the inconvenience to those who have applied or may be in the process of applying, we felt this was the most prudent decision given the gravity of the ongoing public health crisis and uncertainty surrounding its duration.

Summer Internship Program Cancelled

Due to the uncertainty of the duration of the COVID-19 pandemic, the 2020 Summer Internship Program has been cancelled. The program, which is a partnership between the LBA and Central High School, allows students the opportunity to intern for local law firms and offices, gaining insight into the legal profession and the opportunity to interact with legal professionals, as well as valuable work experience. We hope you will consider hiring an intern or sponsoring a student to work in a government or public interest office when the program returns in 2021.

No Leadership Academy in 2020

The ongoing COVID-19 public health emergency has caused the LBA to cancel its planned Leadership Academy this year. Designed for attorneys practicing between 3-10 years, the Leadership Academy helps develop a corps of leaders for the bar and wider community. More than 200 attorneys have completed the Leadership Academy since its inception in 2006. Look for its return in 2021.

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