

## Comments

# Desperate Times Don't Always Call for Desperate Measures: *Professional Engineers v. Schwarzenegger* Through the Lens of the Contract Clause

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### Introduction

ON MARCH 10, 2011 Wisconsin lawmakers voted to strip nearly all collective bargaining rights from public employees in the state.<sup>1</sup> The vote came as a rude awakening to many, notwithstanding the tumultuous weeks of legislative and political theater that preceded it. In mid-February, the Republican Governor of Wisconsin, Scott Walker, introduced a bill<sup>2</sup> that sharply limited collective bargaining rights for most of the state's public employees.<sup>3</sup> The Senate's fourteen Democrats were adamantly opposed to the bill.<sup>4</sup> They fled the state for weeks, thereby preventing the chamber from reaching the necessary quorum to pass the bill.<sup>5</sup> Intent on curbing public sector collective bargaining rights, GOP leaders deleted the bill provisions that triggered the quorum rule.<sup>6</sup> Two hours after convening a special committee, the Repub-

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1. *Wis. Assembly Cuts Public Worker Bargaining Rights*, NPR (Mar. 10, 2011), <http://www.npr.org/2011/03/10/134419331/protests-swell-after-wis-senate-curbs-union-rights>.

2. A.B. 11, 2011 Leg., Spec. Sess. (Wis. 2011) (commonly referred to as 2011 Wisconsin Act 10).

3. *Wis. Assembly Cuts Public Worker Bargaining Rights*, *supra* note 1.

4. *Id.*

5. *Id.*

6. *Id.*

lican committee passed the amended bill.<sup>7</sup> Minutes later, Republican senators met and voted 18-1 in favor of the plan without one Democrat present.<sup>8</sup> The Senate's Democrats were enraged. Democratic Senate Minority Leader Mark Miller said: "In 30 minutes, 18 state senators undid 50 years of civil rights in Wisconsin. Their disrespect for the people of Wisconsin and their rights is an outrage that will never be forgotten."<sup>9</sup>

The events in Wisconsin provide a dramatic example of a state government stripping public sector employees of their collective bargaining rights, but they are not without parallel. Less than a year ago, the Supreme Court of California addressed a similar issue in *Professional Engineers in California Government v. Schwarzenegger*.<sup>10</sup> In that case unions challenged then-Governor Schwarzenegger's Executive Order<sup>11</sup> unilaterally imposing California's first-ever unpaid, two-day-a-month furlough of most state employees.<sup>12</sup> Over 200,000 state government employees were required to miss work two days per month starting in February 2009.<sup>13</sup> The financial impact on furloughed employees was far from theoretical. Sheila Byars, a forty-seven-year-old Department of Motor Vehicles hearing officer in downtown Los Angeles, said the furloughs would cost her about \$400 per month.<sup>14</sup> "It feels like we're being punished because we chose a career in state government," she said.<sup>15</sup>

California statutes governing public sector labor relations require public employers to meet and confer with recognized employee organizations before implementing laws that will affect public employee wages and salaries.<sup>16</sup> The unions argued that Governor Schwarzenegger should have completed the collective bargaining process before implementing the furloughs and that his failure to do so constituted an unconstitutional impairment of contract.<sup>17</sup> In a disjointed opinion,

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7. *Id.*

8. *Id.*

9. *Id.*

10. *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186 (Cal. 2010).

11. Cal. Exec. Order No. S-16-08 (Dec. 19, 2008), available at <http://gov.ca.gov/news.php?id=11310>.

12. *Prof'l Eng'rs*, 239 P.3d at 1190.

13. *Furloughs Begin for Calif. State Workers*, KCRA.COM (Feb. 6, 2009), <http://www.kcra.com/r/18655586/detail.html>.

14. *Id.*

15. *Id.*

16. CAL. GOV'T CODE § 3517 (West 2010).

17. Appellant's Opening Brief at 42, *Serv. Emps. Int'l Union, Local 1000 v. Schwarzenegger*, 112 Cal. Rptr. 3d 52 (Ct. App. 2010) (No. C061020).

which reflected the disorder stemming from the worst recession since the Great Depression, the court ultimately concluded that the state had the authority to implement the mandatory, unpaid, two-day-a-month furlough program.<sup>18</sup> The court largely sidestepped the collective bargaining issue.

The events in California and Wisconsin are not unique. Other states with extreme budget deficits have grappled with whether to target public sector employees as a means to cut spending. Over half of these states attempted to furlough public sector employees.<sup>19</sup> Union members and public employee organizations did not stand by and watch silently—they turned to the judiciary. Several courts which have addressed furloughs specifically, or infringements of government contracts more generally, have done so under the Contract Clause of the U.S. Constitution.<sup>20</sup> Under the Contract Clause, actions that impair government contracts are reviewed under heightened scrutiny.<sup>21</sup> The state bears the burden of proving that the contract impairment is reasonable and necessary to serve a legitimate government purpose.<sup>22</sup>

A number of *Professional Engineers* plaintiffs argued in their briefs that the furlough order unconstitutionally impaired their collective bargaining contracts under the Contract Clause.<sup>23</sup> Because the issue was not raised in the petitions before the trial court, the California Supreme Court declined to rule on the issue.<sup>24</sup> This Comment suggests that, had the court reviewed the Governor's unilateral furlough of public sector employees under the Contract Clause, the court would have found the Governor's action unconstitutional. This Comment argues that the Contract Clause serves as an important and effective restriction when government entities attempt to modify existing contractual agreements without first conferring with the represented employee organization. Analyzing *Professional Engineers* through the lens of the Contract Clause should prove instructive for both unions seeking to implement their rights and state government officials seeking to remedy the state's budget problems. The exercise

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18. *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186, 1190 (Cal. 2010).

19. Katharine Q. Seelye, *To Save Money, States Turn to Furloughs*, N.Y. TIMES, Apr. 23, 2009, at A1, available at <http://www.nytimes.com/2009/04/24/us/24furlough.html>.

20. U.S. CONST. art. I, § 10, cl. 1; see, e.g., *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1103 (9th Cir. 1999); *Donohue v. Paterson*, 715 F. Supp. 2d 306 (N.D.N.Y. 2010).

21. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 30 (1977).

22. *Id.*

23. *Prof'l Eng'rs*, 239 P.3d at 1197 n.11.

24. *Id.*

demonstrates that honoring the Contract Clause is advantageous for both parties. Since the Clause requires the state to consider all policy alternatives before infringing public contracts, the result is a more collaborative, better informed strategy for addressing budget crises.

This Comment proceeds in four parts. Part I summarizes the California Supreme Court's analysis in *Professional Engineers*. Part II provides a brief background on the Contract Clause and examines how two courts have dealt with impairments of public sector employment contracts under the Contract Clause. Part III analyzes the furlough program at issue in *Professional Engineers* under the Contract Clause, finding that the furlough program unconstitutionally impaired the public employees' contracts. Finally, this Comment concludes that the Contract Clause serves as a powerful tool for our nation's public employees working under collective bargaining agreements.

## I. The California Supreme Court's Analysis in *Professional Engineers*

### A. Background

The financial crisis of 2008 was unique in its magnitude. However, California is no stranger to budget crises, as only a few examples from recent history demonstrate. The aerospace boom of the 1980s turned into a bust in the 1990s.<sup>25</sup> The spectacular dotcom growth of the late 1990s sputtered after 2000.<sup>26</sup> Despite California's recurring cycle of boom to bust, prior to 2004 the state had no system in place to deal with fiscal emergencies.<sup>27</sup> In May of 2004, that changed when California voters approved a ballot measure that added Article IV, section 10, subdivision (f) to the California Constitution (hereinafter Article IV, section 10(f)).<sup>28</sup> Under this new constitutional provision, the Governor is authorized to declare a fiscal emergency if he or she determines in the midst of a fiscal year that there will be a substantial, unanticipated budget deficit for that year.<sup>29</sup> Pursuant to the fiscal emergency, the Governor may call a special legislative session and submit proposed legislation to address the problem.<sup>30</sup>

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25. *A Special Report on Democracy in California: The People's Will*, THE ECONOMIST, Apr. 23, 2011, at 3–4.

26. *Id.*

27. *Profl Eng'rs*, 239 P.3d at 1198.

28. CAL. CONST. art. IV, § 10(f).

29. *Id.*

30. *Id.*

Article IV, section 10(f) seemed to come at just the right time for California. At the end of 2007 thirteen states, including California, faced a combined budget shortfall of at least \$23 billion for the 2009 fiscal year.<sup>31</sup> A study from the Center on Budget and Policy Priorities revealed that California, among nine other states, had prepared revenue and spending projections for the 2009 fiscal year which failed to anticipate diminished revenues that were insufficient to sustain state services.<sup>32</sup> California was in the worst position by far, with a staggering projected budget gap of between \$9.8 billion and \$14 billion.<sup>33</sup> California's fiscal circumstances continued to deteriorate as a result of the credit market crisis and the national recession. By the end of 2008, California's budget deficit was projected to grow to at least \$40 billion by the end of the 2009–2010 fiscal year.<sup>34</sup> State officials realized that by as early as February 2009 the state would be unable to meet its payroll and other financial obligations.<sup>35</sup>

On December 1, 2008, California's then-Governor, Arnold Schwarzenegger, declared a fiscal emergency pursuant to Article IV, section 10(f).<sup>36</sup> He called the Legislature into special session and then submitted a comprehensive budget plan to address the budget problem.<sup>37</sup> The plan included a proposal to furlough state employees one day per month through the end of the 2009–2010 fiscal year.<sup>38</sup> Despite the pressure to reduce spending, the Legislature rejected the furlough plan and passed its own proposed budget legislation on December 18 (hereinafter, the 2008 Budget Act).<sup>39</sup> The Legislature's plan reduced funding for state employees by \$240 million for the 2009 fiscal year but required that sources of the savings be decided through collective bargaining.<sup>40</sup> In this way, the 2008 Budget Act specifically excluded the Governor's recommended one-day-a-month furlough provision. The following day, on December 19, Schwarzenegger issued an executive order that would require all state workers employed by the executive branch to take two days of furlough each

31. Elizabeth McNichol & Iris J. Lav, *13 States Face Total Budget Shortfall of at Least \$23 Billion in 2009; 11 Others Expect Budget Problems*, CTR. ON BUDGET & POLICY PRIORITIES (Dec. 18, 2007), <http://www.cbpp.org/files/12-18-07sfp.pdf>.

32. *Id.*

33. *Id.*

34. *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186, 1190 (Cal. 2010).

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. S. Daily Journal, 2009–2010 Leg., 1st Extraordinary Sess. (Cal. Dec 18, 2008).

40. S.B. 3, 2009–2010 Leg., 1st Extraordinary Sess. (Cal. 2008).

month beginning February 9, 2009 and ending June 30, 2010.<sup>41</sup> The furlough plan would be implemented by closing most state offices on the first and third Fridays of each month and would reduce workers' hours and earnings by approximately ten percent.<sup>42</sup> The Governor ultimately vetoed the Legislature's proposed 2008 Budget Act.<sup>43</sup>

The Governor's Executive Order was met with public employee outrage. The president of Service Employees International Union Local 1000 ("SEIU")—the largest state employee union in North America, representing 95,000 workers—stated that her members were "disappointed and angry" with the Governor's Executive Order.<sup>44</sup> Shortly thereafter, SEIU filed a lawsuit in Sacramento Superior Court challenging the order. Other unions took the same approach. The Professional Engineers in California Government ("PECG") and the California Association of Professional Scientists ("CAPS") also filed suit in the Sacramento Superior Court.<sup>45</sup> That case was consolidated with the SEIU lawsuit and with a third lawsuit filed by the California Attorneys, Administrative Law Judges, and Hearing Officers in State Employment ("CASE").<sup>46</sup> The unions sought a writ of mandate directing the Controller and the Governor to not implement the two-day-a-month furlough order and a declaratory judgment finding the Executive Order invalid.<sup>47</sup> They claimed that the Governor did not have the authority to unilaterally implement an involuntary furlough of represented state employees, contending that only the Legislature possessed such authority.<sup>48</sup> On February 11, 2009, the Sacramento Superior Court entered a judgment denying the petitions and ordering the Controller to comply with the Governor's furlough order.<sup>49</sup>

Plaintiffs appealed to the court of appeal. Before the court of appeal could set a date for oral argument, the California Supreme Court transferred the matter to itself and set oral argument for September 8, 2010.<sup>50</sup>

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41. Cal. Exec. Order No. S-16-08 (Dec. 19, 2008).

42. *Id.*

43. Supplement to S. Daily Journal, 2009–2010 Leg., 1st Extraordinary Sess. (Cal. Jan 7, 2009).

44. Matthew Yi, *Governor Orders Layoffs, Unpaid Time Off*, S.F. CHRON., Dec. 20, 2008, at B1, available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/12/20/BA6G14RFID.DTL>.

45. *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186, 1193 (Cal. 2010).

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 1004.

50. *Id.* at 1197.

## B. The California Supreme Court's Decision

The California Supreme Court analyzed the issues presented in *Professional Engineers* by posing two broad questions. The court first addressed whether the Governor possessed the authority to impose the two-day-a-month, unpaid furlough of state employees unilaterally through his December 19, 2008 Executive Order.<sup>51</sup> The court then looked at whether the Legislature retroactively legitimized the Governor's December 19th furlough Order by revising the 2008 Budget Act to reflect the savings from the order.<sup>52</sup> The court found for the employees on the first issue and the government on the second issue.<sup>53</sup>

### 1. Unilateral Furlough Order

The court concluded that the Governor and the Department of Personnel Administration ("DPA") lacked the authority to unilaterally impose mandatory unpaid furloughs on state employees by executive order.<sup>54</sup> The court reached its conclusion on this issue after considering and striking down each of the Governor's arguments. The Governor first claimed that his authority to unilaterally furlough state employees in the face of a fiscal emergency sprung from Article V, section 1 of the California Constitution.<sup>55</sup> That section provides: "The supreme executive power of this State is vested in the Governor. The Governor shall see that the law is faithfully executed."<sup>56</sup> The court observed that the Governor failed to back up his argument with a single case or other supporting authority.<sup>57</sup> Accordingly, the court held that the Governor's reliance on the broad language of Article V was insufficient to counter the well established rule that under the California Constitution, the Legislature—not the Governor—has the ultimate authority to set the terms and conditions of state employment through legislative enactments, regardless of any fiscal emergency.<sup>58</sup>

The Governor alternatively argued that various provisions of the California Government Code afforded him the unilateral authority to impose unpaid furloughs.<sup>59</sup> The Governor relied on section 19851,

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51. *Id.* at 1099.

52. *Id.*

53. *Id.* at 1100–01.

54. *Id.* at 1218–19.

55. CAL. CONST. art. V, § 1; *Profl Eng'rs*, 239 P.3d at 1200–01.

56. CAL. CONST. art. V, § 1.

57. *Profl Eng'rs*, 239 P.3d at 1201.

58. *Id.*

59. *Id.*

subdivision (a), section 19849, and section 3516.5.<sup>60</sup> The court concluded that none of the provisions of the Government Code authorize the Governor's furlough program.<sup>61</sup>

Section 19851(a) lays out the general policy in California regarding the workweek of state employees, stating that:

It is the policy of the state that the workweek of the state employee shall be 40 hours, and that the workday of state employees eight hours, except that workweeks and workdays of a different number of hours may be established in order to meet the varying needs of different state agencies. It is the policy of the state to avoid the necessity for overtime work whenever possible.<sup>62</sup>

The court rejected the Governor's argument that the first sentence of section 19851(a)—establishing a forty-hour workweek and eight-hour day—authorized his furlough order.<sup>63</sup> The furlough plan did not establish different hours to meet the diverse needs of *different* agencies, as the Governor argued.<sup>64</sup> Rather, the plan imposed a blanket rule on all state executive branch agencies with no consideration or even awareness of their "*varying*" needs.<sup>65</sup> The court also held that both the text and the legislative history of section 19851(a) demonstrates that the primary purpose of the section's delineation of "workweek" is to establish the number of hours a state employee must work before he or she is entitled to receive overtime compensation.<sup>66</sup> Using this construction of the statute, the Governor's furlough plan has no effect on the workweek. In weeks where state employees are required to take an unpaid furlough day, the employee's workweek is still forty hours for purposes of section 19851(a), and the employee only becomes eligible for overtime if he or she works more than forty hours that week.<sup>67</sup> Finally, the court noted that the Governor's reliance on 19851(a) was unfitting because the furlough program's primary purpose was to cut state expenses by reducing appropriations for state employee salaries, not to reduce workdays.<sup>68</sup>

60. CAL. GOV'T CODE §§ 19851(a), 19849 (West 2003); *id.* § 3516.5 (West 2010); *Profl Eng'rs*, 239 P.3d at 1207.

61. *Profl Eng'rs*, 239 P.3d at 1213.

62. GOV'T § 19851(a).

63. *Id.*; *Profl Eng'rs*, 239 P.3d at 1208.

64. *Profl Eng'rs*, 239 P.3d at 1208.

65. *Id.*

66. *Id.* at 1208–09.

67. *Id.* at 1210. The court also rejected the argument advanced by a number of plaintiffs that section 19851(a) should be interpreted *to preclude* the Governor from adopting the furlough program. *Id.*

68. *Id.* at 1211.

The court quickly disposed of the Governor's argument based on section 19849, which provides that the DPA shall "adopt rules governing hours of work and overtime compensation."<sup>69</sup> The court reasoned that if section 19851(a) did not authorize the Governor to implement the furloughs, then section 19849, which simply authorizes the DPA to adopt administrative rules for the state employer to enforce, could not provide independent authority.<sup>70</sup>

The court also rejected the Governor's argument that Government Code section 3516.5 authorized the unilaterally imposed furloughs. That section lays out two courses of action for employers seeking to implement laws that will directly affect represented state employees. The first part lays out the rule for ordinary circumstances:

Except in cases of emergency . . . the employer shall give reasonable notice to each recognized employee organization affected by any law . . . directly related to matters within the scope of representation proposed to be adopted by the employer, and shall give such recognized employee organizations the opportunity to meet and confer with the administrative officials or their delegated representatives as may be properly designated by the law.<sup>71</sup>

The second part of the statute lays out the rule for emergencies:

In cases of emergency when the employer determines that a law . . . must be adopted immediately without prior notice or meeting with a recognized employee organization, the administrative officials or their delegated representatives as may be properly designated by law shall provide such notice and opportunity to meet and confer in good faith at the earliest practical time following the adoption of such law.<sup>72</sup>

The court flatly rejected the Governor's argument that section 3516.5 authorized him to institute his involuntary furlough program. The court observed that the plain language of section 3516.5 did not "constitute a source of *substantive* authority for the state to take any particular type of action regarding the terms and conditions of employment."<sup>73</sup> The statute simply provides that when an employer possesses the authority *from some other source* to implement a law that affects represented state employees, it may follow one of two courses of action.<sup>74</sup> In ordinary circumstances the employer must notify and meet and confer with the organization *before* implementing the law. In

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69. CAL. GOV'T CODE § 19849 (West 2003).

70. *Profl Eng'rs*, 239 P.3d at 1212.

71. CAL. GOV'T CODE § 3516.5 (West 2010).

72. *Id.*

73. *Profl Eng'rs*, 239 P.3d at 1212.

74. *Id.*

an emergency, however, the employer may take action and *then* notify and meet and confer with the organization as soon as practicable.<sup>75</sup>

Finally, the court addressed whether some other provision not raised by the parties authorized the Governor or the DPA to unilaterally institute mandatory furloughs. The court examined Government Code section 19826, which governs the DPA's authority to establish or adjust public employee salaries.<sup>76</sup> As an initial matter, the court explained that furloughs unequivocally adjust the salaries of public employees (i.e., they do not simply adjust the schedule or hours an employee works).<sup>77</sup> The statute demonstrates that the Governor's authority over employees varies significantly depending on whether or not the employee is represented, i.e., a member of a union.<sup>78</sup> With regard to *represented* employees, the establishment and adjustment of salaries must be determined through the collective bargaining process.<sup>79</sup> The Governor or DPA was therefore prohibited from unilaterally imposing a mandatory unpaid furlough on *represented* employees unless explicitly granted that authority by the terms of a Memorandum of Understanding ("MOU").<sup>80</sup>

## 2. Revised 2008 Budget Act

In mid-February 2009, soon after the Governor's furlough order went into effect and in further response to the fiscal emergency, the Legislature enacted and the Governor signed legislation that revised the 2008 Budget Act.<sup>81</sup> The new legislation reduced the 2008–2009 fiscal year appropriation for employee compensation by an amount which precisely reflected the savings the Governor sought to achieve through his controversial two-day-a-month furlough order.<sup>82</sup> The revised 2008 Budget Act provided that:

(a) [E]ach item of appropriation in this act . . . shall be reduced, as appropriate, to reflect a reduction in employee compensation achieved through the collective bargaining process for represented employees or through existing administration authority and a proportionate reduction for nonrepresented employees (utilizing existing authority of the administration to adjust compensation for nonrepresented employees) in the total amounts of

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75. *Id.* at 1212–13.

76. *Id.* at 1215.

77. *Id.* at 1216.

78. *Id.* at 1215.

79. *Id.*

80. *Id.* at 1217.

81. *Id.* at 1194.

82. *Id.* at 1222.

\$385,762,000 from General Fund items and \$285,196,000 from items relating to other funds.

(b) The Department of Personnel Administration shall transmit proposed memoranda of understanding to the Legislature promptly and shall include with each such transmission estimated savings pursuant to this section of each agreement.

(c) Nothing in this section shall change or supersede the provisions of the Ralph C. Dills Act.<sup>83</sup>

The plaintiff employee organizations and the Governor strongly disagreed over the meaning of this legislation. Plaintiffs maintained that for represented employees (such as the state employees in this case), appropriations could only be reduced through the collective bargaining process.<sup>84</sup> The Governor countered that reductions for represented employees could be achieved through *either* the collective bargaining process *or* through existing authority.<sup>85</sup> The court agreed with the Governor's interpretation, finding that the first part of the legislation laid out alternative means of achieving reductions for represented employees, while the second part of the clause laid out the means of achieving reductions for non-represented employees.<sup>86</sup> The court reasoned that any other interpretation would make the parenthetical clause superfluous.<sup>87</sup>

The parties also disputed whether the term "existing authority" could reasonably be interpreted to include the Governor's two-day-a-month furlough plan. In their trial briefs, plaintiff employee organizations argued that both the language of subsection (a) and the express reference to the Dills Act (which requires public employers to meet and confer with recognized employee organizations before implementing laws that will affect public employee wages and salaries)<sup>88</sup> in subsection (b) suggest that "existing authority" refers to the possibility that the Governor, through the collective bargaining process, had already reached agreements with the bargaining representatives of various employee organizations regarding furloughs.<sup>89</sup>

The court, in contrast, concluded that "existing authority" could reasonably be interpreted to mean that reductions could be achieved through the then-existing furlough plan authorized by the Governor

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83. S.B. 2, 2009–2010 Leg., 3d Extraordinary Sess. § 36 (Cal. 2009).

84. *Profl Eng'rs*, 239 P.3d at 1222.

85. *Id.*

86. *Id.*

87. *Id.*

88. CAL. GOV'T CODE §§ 3516–3516.5 (West 2010).

89. Letter Brief of Appellants at 7, *Profl Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186 (2010) (No. S183411).

through executive order, even though the appellate courts had not yet determined whether the Governor was authorized to impose the furloughs unilaterally.<sup>90</sup> The court dismissed plaintiffs' argument, stating that "nothing in the Dills Act precludes *the Legislature* from adopting such a furlough plan through legislative enactment as one method of reducing the compensation of state employees when such cuts are found necessary and appropriate in light of the state's fiscal condition."<sup>91</sup> The court concluded that while the Governor lacked the authority to reduce employee pay through furloughs, the Legislature retroactively legitimized the Governor's December 19th furlough order by adopting the revised 2008 Budget Act legislation that reflected the savings from the order.<sup>92</sup>

## II. The Contract Clause and Public Contracts

The Contract Clause of the U.S. Constitution provides that "[n]o state shall . . . pass any . . . Law impairing the Obligation of Contracts."<sup>93</sup> Similarly, the California Constitution provides that a "law impairing the obligation of contracts may not be passed."<sup>94</sup> The Clause serves as a protection against state and local laws that interfere with rights under existing contracts.<sup>95</sup> A state action impairs a contractual obligation when it "prevents or materially limits the contractor's ability to enforce his contractual rights," for example, by limiting remedies that would otherwise be available in a contractual relationship between two private parties.<sup>96</sup> In the public employee context, when a state government entity with lawmaking authority, such as the state legislature, enacts a law that trumps the terms of a collective bargain-

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90. *Profl Eng'rs*, 239 P.3d at 1222.

91. *Id.* at 1223.

92. *Id.*

93. U.S. CONST. art. I, § 10, cl. 1.

94. CAL. CONST. art. I, § 9. For simplicity, I will refer to the federal and state Contract Clauses collectively as the "Contract Clause" or "Clause."

95. See *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 264 (1827) (holding that the Contract Clause only applies to already existing contracts); *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 139–40 (1810) (holding that the Contract Clause applied not only to contracts between private parties, but also to contracts to which a state was a party). The Contract Clause does not apply to federal laws that interfere with contractual rights. ERWIN CHEMERINSKY, CONSTITUTIONAL LAW 647 (3d ed. 2009).

96. *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1103 (9th Cir. 1999). In *Horowitz-Matthews, Inc. v. City of Chicago*, 78 F.3d 1248, 1250–51 (7th Cir. 1996), the Seventh Circuit noted that courts differentiate between state actions which establish mere breach of contract and those which rise to the level of an impairment of contract. The Contract Clause is not implicated in the former context, in part because the injured party retains the right to recover damages for the breach. *Id.*

ing agreement, the Clause may serve as a limitation on the entity's lawmaking authority.<sup>97</sup> The Clause also applies when a court issues a ruling that interferes with the terms of a collective bargaining agreement.<sup>98</sup>

The vitality of the Contract Clause has varied over the years. For the first century of our nation's history, the Contract Clause served as the chief federal constitutional limit on state and local regulation of business.<sup>99</sup> Litigants and courts employed the Clause aggressively during this time because it was the only constitutional provision that could be used to limit state interference with property rights.<sup>100</sup> The Clause became less powerful in the years following adoption of the Fourteenth Amendment and the growth of the Supreme Court's substantive due process jurisprudence.<sup>101</sup> For example, for a brief period following the U.S. Supreme Court's ruling in *Lochner v. New York*,<sup>102</sup> the Clause became largely superfluous because the Due Process Clause protected both existing and future contracts, whereas the Contract Clause protected only existing contracts.<sup>103</sup> In the New Deal era, state and local legislation served largely to protect employee rights. During this time, courts generally deferred to state legislative impairments whenever a state regulation was seen as a legitimate exercise of the state's police powers.<sup>104</sup>

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97. Stephen F. Befort, *Unilateral Alteration of Public Sector Collective Bargaining Agreements and the Contract Clause*, 59 BUFF. L. REV. 1, 2 (2011).

98. See *Bradley v. Super. Ct.*, 310 P.2d 634, 640 (Cal. 1957) ("Neither the court nor the Legislature may impair the obligation of a valid contract and a court cannot lawfully disregard the provisions of such a contract or deny to either party his rights thereunder."); Appellant's Opening Brief at 44, *Serv. Emps. Int'l Union, Local 1000 v. Schwarzenegger*, 112 Cal. Rptr. 3d 52 (Ct. App. 2010) (No. C061020).

99. Leo Clarke, *The Contracts Clause: A Basis for Limited Judicial Review of State Economic Regulation*, 39 U. MIAMI L. REV. 183, 187 (1985).

100. *Id.*

101. *Id.* at 187–88.

102. *Lochner v. New York*, 198 U.S. 45 (1905) (holding that the freedom to contract was a basic liberty protected by the Due Process Clause of the Fourteenth Amendment). *Id.* at 53.

103. See *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 264 (1827) (holding that the Contract clause only applies to already existing contracts); CHEMERINSKY, *supra* note 95, at 647; see also Befort, *supra* note 97, at 22 (noting that the "relative importance of the contract clause began to wane following the adoption of the Fourteenth Amendment" because the Fourteenth Amendment applies to both existing and future contracts, while the Contract Clause only serves as a protection for existing contracts).

104. See Clarke, *supra* note 99, at 190–92; see also *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 438 (1934) ("The question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end.").

In 1977, the U.S. Supreme Court breathed new life into the Contract Clause when it decided *United States Trust Co. of New York v. New Jersey*.<sup>105</sup> The case presented a challenge to a 1974 New Jersey statute that, together with a parallel New York statute, repealed a statutory covenant made between the two states in 1962. The 1962 covenant prohibited the Port Authority of New Jersey and New York from using toll revenues to subsidize railroad passenger service.<sup>106</sup> United States Trust Company of New York, as both a trustee for and holder of Port Authority bonds, brought suit claiming that the New Jersey statute impaired the obligation of the States' contract with the bondholders.<sup>107</sup> The Court held that the Contract Clause of the U.S. Constitution prohibited the retroactive repeal of the 1962 covenant.<sup>108</sup>

*United States Trust* adopted a heightened standard for examining laws that impair public contracts.<sup>109</sup> The Court formulated a tripartite framework to balance the vested rights of individuals under existing contracts with the states' need to invoke their police power to provide for the welfare of their citizens. Under this standard, courts examine: (1) whether a contractual obligation is present, (2) whether the state's actions impaired that contract, and (3) whether the impairment was reasonable and necessary to serve an important public purpose.<sup>110</sup> The Court reasoned that, in the context of public contracts, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake."<sup>111</sup> When a state is a party to its own contract, that state is "not completely free to consider impairing the obligations of its own contract on par with other policy alternatives."<sup>112</sup>

After *United States Trust*, courts distinguish between government interference with private contracts and government interference with its own contractual obligations, using a much stricter standard of review for the latter interference.<sup>113</sup> Thus, while the Contract Clause may still be applied to laws that impact private contracts, it is most

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105. U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1 (1977).

106. *Id.* at 3.

107. *Id.*

108. *Id.* at 32.

109. *Id.* at 25–26.

110. *Id.* at 21, 26.

111. *Id.* at 26.

112. *Id.* at 30.

113. Clarke, *supra* note 99, at 198.

frequently implemented to limit states' power to modify contracts to which they are a party.<sup>114</sup>

#### A. The Ninth Circuit Questions Emergency Pay Day Delay Legislation

Public employees are a politically expedient target when states are forced to cut spending. However, when courts analyze contractual impairments under the federal Contract Clause, the easiest methods of cutting spending often do not prevail. In *University of Hawaii Professional Assembly v. Cayetano*, Hawaii state employees challenged a statute which allowed the State to postpone by several days, at six different times, the dates on which state employees were paid.<sup>115</sup> The Ninth Circuit held that a state statute that delayed the issuance of payroll checks substantially impaired a collective bargaining agreement and violated the federal Contract Clause.<sup>116</sup>

Following the *United States Trust* framework, the court initially concluded that the collective bargaining agreement constituted a contractual agreement between Hawaii state employees and the State.<sup>117</sup> The court found that “a course of dealing can create a contractual expectation.”<sup>118</sup> Thus, although the collective bargaining agreements contained no specific pay day provisions, the State and its employees had maintained an understanding for over twenty-five years that employees would be paid on the fifteenth and last days of each month.<sup>119</sup> This understanding was sufficient to constitute a contractual agreement for the purposes of Contract Clause analysis.

The court found that the pay delay impaired collective bargaining agreements.<sup>120</sup> In determining whether an impairment is substantial, courts must consider the extent to which the affected employees' reasonable expectations under the contract are disrupted.<sup>121</sup> Here, the court observed that “[p]laintiffs are wage earners, not volunteers,” and that the state employees had “bills, child support obligations, mortgage payments, insurance premiums, and other responsibilities.”<sup>122</sup> As such, plaintiffs reasonably relied on the timely receipt of

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114. See Befort, *supra* note 97, at 24.

115. Univ. of Haw. Prof'l Assembly v. Cayetano, 183 F.3d 1096, 1099 (9th Cir. 1999).

116. *Id.*

117. *Id.* at 1102.

118. *Id.*

119. *Id.*

120. See *id.* at 1104–06.

121. *Id.* at 1105.

122. *Id.* at 1106.

their paychecks.<sup>123</sup> Even a slight delay could be extremely detrimental.

Having determined that the Hawaii statute constituted a substantial impairment of contract, the Ninth Circuit considered whether the impairment was reasonable and necessary to fulfill an important public purpose. The court initially addressed the level of deference afforded to a state where the employees were on the payroll of the government entity that impaired those rights. Courts are “less deferential to a state’s judgment of reasonableness and necessity when a state’s legislation is self serving and impairs the obligations of its *own* contracts.”<sup>124</sup> Courts have subsequently referred to this heightened level of scrutiny as “less deference scrutiny.”<sup>125</sup> This more exacting standard is appropriate in this context because “[a] governmental entity can always find a use for extra money, especially when taxes do not have to be raised.”<sup>126</sup> To determine reasonableness under less deference scrutiny, courts look to the extent of the impairment and the public purpose served by the impairment.<sup>127</sup> The federal Contract Clause prohibits states from impairing contractual obligations without first pursuing other policy alternatives.<sup>128</sup> A contractual impairment is not considered necessary if it imposes an extreme impairment when an apparent and more moderate method would be equally as effective or if the contractual impairment was unreasonable based on the surrounding circumstances.<sup>129</sup>

The Ninth Circuit concluded that the Hawaii statute was neither reasonable nor necessary.<sup>130</sup> Defendants could have pursued other less politically favorable alternatives, such as a federal maximization project, the repeal of tax credits, or raising taxes.<sup>131</sup> Defendants failed to articulate why Hawaii’s budgetary problems were best solved by targeting state personnel.<sup>132</sup> Additionally, the court found that defendants acted unreasonably in light of the surrounding circumstances, pointing out that contractual impairments are not reasonable if the problem the state seeks to remedy with the impairment existed

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123. *See id.*

124. *Id.* at 1107 (citing *Condell v. Bress*, 983 F.2d 415, 418 (2d Cir. 1993)).

125. *Donohue v. Paterson*, 715 F. Supp. 2d 306, 321 (N.D.N.Y. 2010).

126. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 26 (1977).

127. *Univ. of Haw.*, 183 F.3d at 1107.

128. *See U.S. Trust Co.*, 431 U.S. at 30–31 (1977).

129. *Univ. of Haw.*, 183 F.3d at 1107.

130. *Id.*

131. *Id.*

132. *Id.*

at the time the parties entered the contractual agreement.<sup>133</sup> In this case, defendants were aware of the fiscal crisis at the time the collective bargaining agreement was entered into.<sup>134</sup> After weighing the competing hardships, the Ninth Circuit concluded that plaintiffs had shown a likelihood of success on the merits.<sup>135</sup>

### **B. The Northern District of New York Blocks Implementation of Furloughs**

A federal district court in New York reached a similar outcome to *University of Hawaii* in 2010. In *Donohue v. Paterson*, the court used the federal Contract Clause to strike down wage freeze and furlough provisions initiated by the Governor in the wake of the most recent fiscal emergency.<sup>136</sup> With a projected budget gap of \$6.8 billion for fiscal year 2011, New York faced the fourth largest projected budget gap in the nation.<sup>137</sup> Like California, the State of New York is a party to collective bargaining agreements with numerous public employee organizations.<sup>138</sup> As such, the State agrees to contracts establishing the terms and conditions of employment for members of the represented organizations. Nonetheless, in response to the fiscal crisis, the Governor of New York submitted and the Legislature passed, emergency appropriation “extender bills.”<sup>139</sup> The bills contained furlough and wage provisions which resulted in a twenty percent pay reduction for affected workers and specifically eliminated for certain workers the raises previously negotiated through collective bargaining.<sup>140</sup>

Unions and union officials representing public employees challenged the emergency appropriation extender bills under the federal Contract Clause.<sup>141</sup> The court initially found that the challenged provisions of the extender bills constituted a substantial impairment of contract.<sup>142</sup> The court held that full-time employment and contracted for workers’ salary increases were fundamental aspects of the collec-

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133. *Id.*

134. *Id.*

135. *Id.* at 1108.

136. *Donohue v. Paterson*, 715 F. Supp. 2d 306, 325 (N.D.N.Y. 2010).

137. Colin Barr, *More and More States on Budget Brink*, CNNMONEY (Jan. 17, 2010), <http://money.cnn.com/2010/01/14/news/economy/states.woes.fortune/index.htm?postversion=2010011713&iid=EL>.

138. *Donohue*, 715 F. Supp. 2d at 313.

139. *Id.* An “extender bill” temporarily funds the continued operation of the State in the absence of an official budget. *Id.*

140. *Id.*

141. *Id.* at 311–14.

142. *Id.* at 319.

tive bargaining agreement that plaintiffs had bargained for.<sup>143</sup> As such, the State disrupted plaintiffs' reasonable expectations under the contracts by seeking to reduce full-time employment and to delay contracted for increases in salaries.<sup>144</sup>

The court next turned to whether the bills served a legitimate public purpose. For the sake of argument, the court agreed with defendants<sup>145</sup> that the fiscal crisis constituted a legitimate public purpose.<sup>146</sup> However, the court noted that a state government's authority to substantially impair its own contracts in furtherance of a legitimate public purpose is less compelling where the government has strayed from the ordinary course of its constitutional process.<sup>147</sup> Because of the emergency nature of the appropriation bills, the executive and legislative bodies did not have the opportunity to evaluate, in their respective capacities, how best to serve the public good.<sup>148</sup> Rather, "the contractual impairments were the sudden and sole work of the Executive and were proposed in a manner that largely precluded legislative deliberation."<sup>149</sup>

Turning to the reasonable and necessary prong, the court noted that defendants' inability to cite any legislative consideration of policy alternatives cast "serious doubt" on the reasonableness and necessity of the extender bills.<sup>150</sup> Additionally, the court was not persuaded by defendants' exclusive reliance on the state's fiscal difficulties and automatic rejection of plaintiffs' suggested alternatives. Defendants failed to articulate either why they targeted unionized state employees or why they had not considered alternatives that imposed a less severe burden on contracts.<sup>151</sup> The court also found that defendants had acted unreasonably in light of the surrounding circumstances.<sup>152</sup> The emergency nature of the extender bills did not allow for normal legislative deliberation.<sup>153</sup> Consequently, "the question of reasonableness

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143. *Id.*

144. *Id.*

145. Defendants' briefs emphasized the severity of New York's fiscal crisis: "The State of New York is in the midst of the most serious and sustained economic downturn since the Great Depression." Defendant's Memorandum of Law in Opposition to Motion for Preliminary Injunction at 1, *Donohue v. Paterson*, 715 F. Supp. 2d 306 (N.D.N.Y. 2010) (No. 1:10-CV-00549).

146. *Donohue*, 715 F. Supp. 2d at 321.

147. *Id.* at 320.

148. *See id.* at 321.

149. *Id.* at 320.

150. *Id.* at 322.

151. *Id.* at 323.

152. *Id.*

153. *Id.*

and necessity of the provisions [was] buried within a precarious legislative choice, as a vote for approval [was] a vote against shutdown.”<sup>154</sup> After completing its *United States Trust* analysis, the court concluded that the challenged provisions of the extender bills constituted an unconstitutional impairment of contract.<sup>155</sup>

### III. *Professional Engineers Through the Contract Clause Lens*

In *Professional Engineers*, SEIU argued that the Governor’s Executive Order constituted an unconstitutional impairment of contract.<sup>156</sup> The trial court refused to address the unconstitutional impairment of contract issue because SEIU had not raised the claim in its writ petition.<sup>157</sup> A number of plaintiffs also raised the same claim in briefs filed with the California Supreme Court, but the court declined to address the issue for the same reason: because the employees did not raise the claim in their petitions, the issue was not properly before the court.<sup>158</sup> This Comment analyzes the unconstitutional impairment of contract claim that both courts declined to address. This Comment argues that, had the issue been property before the court, the court would have found that the furlough plan violated the Contract Clause of both the United States and California Constitutions.

As recognized by Professor Stephen F. Befort, “[c]ontract clause analysis under the *United States Trust* standard is a fact-intensive endeavor.”<sup>159</sup> The court must first determine whether there has been a substantial impairment of contract and then conduct a precise balancing of factors relating to whether the impairment was reasonable and necessary under the circumstances. Applying the *United States Trust* principles to *Professional Engineers* compels only one conclusion: the

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154. *Id.*

155. *Id.* at 325.

156. *Prof’l Eng’rs in Cal. Gov’t v. Schwarzenegger*, 239 P.3d 1186, 1197 (Cal. 2010).

157. *Id.* SEIU’s failure to raise the unconstitutional impairment of contract claim in its writ petition may have been a litigation strategy. The Contract Clause is not implicated unless a “law” impairs an already existing contract. SEIU’s original argument hinged on the lack of authority for Governor Schwarzenegger to implement furloughs by executive order alone. No legislative authority existed to support the Governor’s Executive Order, as the Legislature had not yet passed the revised 2008 Budget Act. Thus, from SEIU’s perspective, there was simply no “law” to implicate the Contract Clause. Another potential reason why SEIU initially declined to raise the Contract Clause claim was that the MOUs affected by the Governor’s order were expired, though they remained binding by virtue of a continuing benefits provision of the California Government Code. For a more detailed discussion of the expired MOU issue see *infra* Part III.A.

158. *Id.*

159. Befort, *supra* note 97, at 40.

Governor's implementation of involuntary, unpaid furloughs on represented state employees constituted an unconstitutional impairment of contract.

### A. The Contractual Relationship

Under *United States Trust*, the first inquiry is whether a contractual agreement existed between the California employees and the State. The payment of salary to public employees involves obligations protected by the Contract Clause of the Constitution.<sup>160</sup> In California, statutes governing public sector labor relations grant public employees private contractual rights enforceable against the State.<sup>161</sup> Specifically, the Ralph C. Dills Act requires public employers to meet and confer in good faith with recognized employee organizations on all matters relating to employment conditions, including wages.<sup>162</sup> If the parties reach an agreement, they must memorialize it in a Memorandum of Understanding and present it to the Legislature for approval.<sup>163</sup> Once approved by the Legislature, an MOU becomes "indubitably binding."<sup>164</sup> In *Professional Engineers*, the California Supreme Court found that the Dills Act makes it "clear that an MOU, once approved by the Legislature (either directly . . . or through the appropriation of sufficient funds to pay the agreed-upon employee compensation), governs the wages and hours of the state employees covered by the MOU."<sup>165</sup> Thus, a state's repudiation of its obligations under an indubitably binding contract may constitute a Contract Clause violation.

In *University of Hawaii*, the Ninth Circuit found that a contractual agreement governing pay days existed *even where* the collective bargaining agreements between employees and the State contained no specific pay day provisions.<sup>166</sup> The court reasoned that the employees had developed an understanding that they would be paid on certain days.<sup>167</sup> This understanding, the court concluded, was sufficient evidence of a contractual agreement for Contract Clause purposes.<sup>168</sup> Following the Ninth Circuit's reasoning, a contractual agreement

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160. See *Kern v. City of Long Beach*, 179 P.2d 799, 802 (Cal. 1947).

161. CAL. GOV'T CODE §§ 3512–3524 (West 2010).

162. *Id.* §§ 3516, 3517, 3570.

163. *Id.* § 3517.5.

164. *Glendale City Emps.' Ass'n v. City of Glendale*, 540 P.2d 609, 615 (Cal. 1975).

165. *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186, 1219 (Cal. 2010).

166. *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1102 (9th Cir. 1999).

167. *Id.*

168. *Id.*

surely existed in *Professional Engineers* because the California employees' expectations were based on both an "understanding" and on an actual labor contract. When Governor Schwarzenegger issued his Executive Order on December 19, 2008, the terms of labor contracts explicitly governed the salaries and hours of the state employees at issue in this case.<sup>169</sup> Governor Schwarzenegger circumvented the collective bargaining requirements of the Dills Act by unilaterally imposing furloughs.

The existing MOUs of each employee organization explicitly laid out salary and benefit levels. Additionally, the MOUs specifically addressed the possibility of furloughs as an alternative to layoffs. The MOUs made clear that the State had to notify and meet and confer with the unions *before* resorting to furloughs.<sup>170</sup> One of the MOUs illustrates the clarity with which the employee organizations addressed the issue:

Whenever the State determines it is necessary to lay off employees, the State and the Union shall meet in good faith to explore alternatives to laying off employees such as . . . *voluntary* reduced work time . . . . The State may propose to reduce the number of hours an employee works as an alternative to lay-off. Prior to implementation of this alternative to a layoff, the State will notify and meet and confer with the Union to seek concurrence of the usage of this alternative.<sup>171</sup>

While all of the applicable MOUs in the instant case had expired on June 30, 2008, they continued to bind the parties. Under the "continuing benefits" provision of the Dills Act, the terms of the expired MOUs remain in effect until a new agreement is reached through collective bargaining or the parties reach an impasse in negotiations.<sup>172</sup> The continuing benefits provision of the Dills Act constitutes an implied legislative declaration that the provisions of public employee collective bargaining agreements, even if expired, warrant special

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169. *Profl Eng'rs*, 239 P.3d at 1218–19.

170. *Id.* at 1219 n.35.

171. Agreement Between State of Cal. and Cal. Attorneys, Admin. Law Judges and Hearing Officers in State Employment (CASE) Covering Bargaining Unit 2 Attorneys and Hearing Officers §§ 10.2–10.3, Effective July 1, 2005 Through June 30, 2007 (emphasis added), available at <http://www.dpa.ca.gov/bargaining/contracts/pdf/bu02/20050701-20070630/mou.pdf>.

172. CAL. GOV'T CODE § 3517.8(a) (West 2010) provides:

If a memorandum of understanding has expired, and the Governor and the recognized employee organization have not agreed to a new memorandum of understanding and have not reached an impasse in negotiations . . . the parties to the agreement shall continue to give effect to the provisions of the expired memorandum of understanding . . . .

protection. In the instant case, the parties had not even begun the meet and confer process, let alone continued to impasse.<sup>173</sup> The Governor and the DPA conceded, and the California Supreme Court confirmed, that the expired MOUs continued to govern the salaries and hours of state employees affected by the furloughs.<sup>174</sup>

Additionally, the California Supreme Court held that the Legislature had approved the MOUs when it adopted the *initial* 2008 Budget Act. The appropriations in the initial Budget Act reflected the level of compensation paid to state employees before the furloughs.<sup>175</sup> “[B]y enacting appropriations in the *initial* 2008 Budget Act that were consistent with the higher level of compensation at which the employees were being paid before the furlough was implemented, the Legislature approved that level of compensation.”<sup>176</sup> Thus, when the Legislature adopted the initial Budget Act, the MOUs between represented state employees and the State (which excluded the two-day-a-month furlough program) became “indubitably binding” contracts.

## B. Substantial Contractual Impairment

The second inquiry under *United States Trust* is to determine whether the furloughs substantially impaired the contract between California employees and the State. The California employees must prove that their reasonable expectations under the contract were disrupted. In considering whether uncompensated furloughs constituted a substantial contractual impairment in *Donohue v. Paterson*, the district court recognized that full-time employment was a fundamental aspect of the collective bargaining agreements that New York employees bargained for and upon which they reasonably relied.<sup>177</sup> The same reasoning holds true in the instant matter. California public employees committed themselves to personal long-term obligations including mortgages, credit cards, car payments, insurance premiums, and child support with the expectation that they would continue receiving their full time salary. An involuntary furlough program resulting in a ten percent pay reduction is certainly a substantial impairment to a public employee confronted with these monthly debt payments and the daily expenses for food and other necessities of life. “For a poor man . . . to lose part of his salary often means his family will go without the essen-

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173. See *Profl Eng'rs*, 239 P.3d at 1190, 1218–19.

174. *Id.* at 1218–19.

175. *Id.* at 1220.

176. *Id.*

177. *Donohue v. Paterson*, 715 F. Supp. 2d 306, 319 (N.D.N.Y. 2010).

tials.”<sup>178</sup> Less time for less pay is “only an option for workers who can afford to make the trade-off.”<sup>179</sup>

### C. State’s Justification

#### 1. Legitimate Public Purpose

After a substantial impairment of contract is found, in order to withstand a Contract Clause challenge the Governor must establish that the furloughs serve a legitimate public purpose. As a general rule, the purpose of the impairment cannot “be simply the financial benefit of the sovereign.”<sup>180</sup> Some courts have found that a state government’s fiscal emergency may constitute a legitimate public purpose.<sup>181</sup> When Governor Schwarzenegger ordered the two-day-a-month furlough of state employees, he based it on a fiscal emergency—a \$15 billion deficit that was projected to grow to a \$42 billion budget gap over the following eighteen months if revenues and expenses continued as expected.<sup>182</sup> While Governor Schwarzenegger’s furloughs financially benefited the state, the nationwide fiscal crisis and the attendant strains on the California budget certainly caused a fiscal emergency. In this sense, a court could reasonably find that the Governor’s attempt to reduce the staggering budget deficit constituted a legitimate public purpose. However, echoing the federal district court in *Donohue v. Paterson*, “the public purpose inquiry as to the challenged provision is not immediately resolved by reference to the State’s budgetary problems.”<sup>183</sup> A state government’s authority to substantially impair one of its contracts, even in the face of a staggering budget deficit, is less compelling where the government has strayed from the course of its ordinary constitutional process.<sup>184</sup>

The district court in *Donohue* doubted the existence of a legitimate public purpose where “the contractual impairments were the sudden and sole work of the Executive and were proposed in a manner that largely precluded legislative deliberation.”<sup>185</sup> The court rea-

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178. *Sniadach v. Family Fin. Corp. of Bay View*, 395 U.S. 337, 342 n.9 (1969) (quoting 114 CONG. REC. 1833 (1968) (statement of Rep. Henry Gonzalez)).

179. Michael Z. Green, *Unpaid Furloughs and Four-Day Work Weeks: Employer Sympathy or a Call for Collective Employee Action*, 42 CONN. L. REV. 1139, 1167 (2010).

180. *Buffalo Teachers Fed’n v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006).

181. *Id.* at 369.

182. *Studies Point to Folly of Across-the-Board Furloughs*, CAL. PUB. EMP. REL. J., Nov. 2009, at 45.

183. *Donohue v. Paterson*, 715 F. Supp. 2d 306, 320 (N.D.N.Y. 2010).

184. *Id.* at 321.

185. *Id.* at 320.

soned that the executive and legislative bodies had not, in their respective capacities, had the opportunity to evaluate what the public good was and how best to serve it. In the present case, Governor Schwarzenegger similarly strayed from the ordinary course of California's constitutional process. The Legislature expressly disapproved of Schwarzenegger's furlough provision, as illustrated by its refusal to include furloughs in its initial 2008 Budget Act.<sup>186</sup> The Legislature made clear that reductions in appropriations for state employees were to be achieved through the collective bargaining process.<sup>187</sup> In rejecting the Governor's initial proposal to implement furloughs, the Legislature denied the legitimacy of the contractual impairment created by the furloughs. Governor Schwarzenegger ignored the Legislature's disapproval and implemented the furloughs by executive order.

Following the Governor's Executive Order, California's elected officials, including Controller John Chiang and Treasurer Bill Lockyer, refused to participate in the furloughs, citing both economic and legal concerns.<sup>188</sup> In a letter to DPA Director David Gilb, Treasurer Lockyer wrote: "We will not comply with an Executive Order that we are convinced does not rest on solid legal grounds and which would impose such a hardship on the backs of our employees."<sup>189</sup> Controller Chiang joined the unions in their suit against the State, publicly refusing to comply with the Order until compelled to do so by court order.<sup>190</sup>

The vocal opposition to the Order by both the Legislature and other key state officials demonstrates the widely-held perception that the furloughs were implemented on dubious procedural grounds.<sup>191</sup> The circumstances surrounding the Order cast doubt on the claim that the furloughs furthered a legitimate public purpose. Nonetheless, this Comment, like the court in *Donohue*, assumes for the sake of argu-

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186. See *Unions Challenge Furlough and Layoff Order*, CAL. PUB. EMP. REL. J., Feb. 2009, at 40 ("the Democrat's budget required that sources of the savings be decided through collective bargaining").

187. *Id.*

188. *Id.* at 41; *Local 1000 Fights Governor's Demand for Unpaid Furloughs Starting Next Month*, SEIU LOCAL 1000, Jan. 17, 2009, at 1 [hereinafter SEIU Local 1000 Union Update], available at [http://seiu1000.org/union\\_update/update\\_01\\_14\\_09.pdf](http://seiu1000.org/union_update/update_01_14_09.pdf).

189. *Id.*

190. See *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186, 1193, 1197 (Cal. 2010).

191. The following state elected officials also issued statements saying they would cut costs but would not comply with the Governor's furlough plan: Attorney General Jerry Brown, Secretary of State Debra Bowen, Lt. Governor John Garamendi, and State Superintendent of Schools Jack O'Connell. SEIU Local 1000 Union Update, *supra* note 188, at 1.

ment that the Governor's attempt to deal with California's financial crisis constituted a legitimate public purpose. As such, this Comment shall analyze whether the furlough order was reasonable and necessary to narrow California's expanding budget gap.

## 2. Reasonable and Necessary Means

To withstand challenge under the Contract Clause, the furlough order must be reasonable and necessary to meet the stated legitimate public purpose. Here, like the states involved in *Donohue* and *University of Hawaii*, the State of California is a party to the contract at issue. As such, complete deference to the Governor's judgment of reasonableness and necessity is not appropriate because the State's self-interest is at stake. The Contract Clause, if it is to mean anything, must prohibit California from violating its own contractual obligations when other policy alternatives are available. As noted by the California Supreme Court, the terms of a binding MOU must be honored, otherwise "[w]hat point would there be in reducing it to writing, if the terms of the contract were of no legal consequence?"<sup>192</sup> To justify the substantial contractual impairment, Governor Schwarzenegger would have had to show that the furloughs were reasonable in light of the surrounding circumstances and that he considered other alternatives before unilaterally implementing the furlough program.

To determine reasonableness, courts consider whether the state can demonstrate a substantial record of considered alternatives.<sup>193</sup> The *Donohue* court specifically stated that reference to the state's budgetary problems is not sufficient to constitute a finding of reasonableness and necessity under the Contract Clause.<sup>194</sup> In *Professional Engineers*, Governor Schwarzenegger failed to show that he considered policy alternatives prior to implementing the two-day-a-month furlough program by executive order. Rather, the Governor relied solely on the fiscal emergency and the *possibility* that the state would be unable to meet its financial obligations by February 2009.<sup>195</sup> The Governor asserted that "in the December 1, 2008 fiscal emergency extraordinary session, the Legislature failed to effectively address the unprecedented statewide fiscal crisis."<sup>196</sup> However, he did not expand on *why* the Legislature's approach to the fiscal crisis was ineffective or

192. *Glendale City Emps.' Ass'n v. City of Glendale*, 540 P.2d 609, 614 (Cal. 1975).

193. *Donohue v. Paterson*, 715 F. Supp. 2d 306, 321–22 (N.D.N.Y. 2010).

194. *Id.*

195. *Prof'l Eng'rs*, 239 P.3d at 1192.

196. *Id.*

*why* the furlough program was necessary. Simply put, Governor Schwarzenegger's public explanation for the furlough program failed to carry the day.<sup>197</sup>

Similarly, the Legislature's revised 2008 Budget Act makes only brief mention of the Governor's proposed furloughs, and certainly does not include a substantial record of considered alternatives.<sup>198</sup> The lack of transparency makes it impossible to determine whether the Legislature considered policy alternatives before authorizing the Governor's furlough order. The California Supreme Court's request for supplemental briefing on whether the revised Budget Act affected the validity of the furloughs demonstrates that it was unclear whether the Legislature even intended the revised Budget Act to address the Governor's furloughs.<sup>199</sup> The unions maintained that the revised Budget Act had absolutely no effect on the validity of the Governor's furloughs.<sup>200</sup> Furthermore, they argued that the language of the Budget Act indicated the Legislature's intent to protect each side's bargaining rights.<sup>201</sup> The State argued the opposite conclusion, claiming that in amending the Budget Act the Legislature intended to validate the Governor's use of furloughs to achieve personnel cost savings.<sup>202</sup> The parties' diametrically opposed interpretations of the revised Budget Act reflect the ambiguity of the revision. On this record, the Legislature failed to make the requisite showing of a "substantial record of considered alternatives."<sup>203</sup>

A contractual impairment will likely not be considered reasonable and necessary if the state imposed a drastic impairment when an "evident and more moderate course was available."<sup>204</sup> A recent study conducted by the University of California at Berkeley's Center for La-

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197. The deliberative processes surrounding executive orders are completely restricted for fifty years following the Order (if any deliberative process even exists). Telephone Interview with Reference Librarian, Cal. State Archives (April 21, 2011).

198. See Office of Senate Floor Analyses, Cal. State Senate, Third Reading of S.B. 2, 2009–2010 Leg., 3d Extraordinary Sess. (Cal. Feb. 14, 2009), available at [http://www.leginfo.ca.gov/pub/09-10/bill/sen/sb\\_0001-0050/sbx3\\_2\\_cfa\\_20090214\\_215826\\_sen\\_floor.html](http://www.leginfo.ca.gov/pub/09-10/bill/sen/sb_0001-0050/sbx3_2_cfa_20090214_215826_sen_floor.html).

199. See *Prof'l Eng'rs*, 239 P.3d at 1197 n.12. The California Supreme Court spent seven pages discussing whether the revised 2008 Budget Act should be construed to authorize the Governor's furlough order. *Id.* at 1220–26.

200. Appellant's Supplemental Letter Brief at 6, *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186 (Cal. 2010) (No. S183411).

201. *Id.*

202. Supplemental Letter Brief in Response to Court's June 9, 2010 Order at 8, *Prof'l Eng'rs in Cal. Gov't v. Schwarzenegger*, 239 P.3d 1186 (Cal. 2010) (No. S183411).

203. *Donohue v. Paterson*, 715 F. Supp. 2d 306, 322 (N.D.N.Y. 2010).

204. *Id.*

bor Research and Education casts serious doubt on the reasonableness and necessity of the furloughs.<sup>205</sup> Drawing on standard economic theory and empirical research, the Berkeley study found that the furloughs were “a particularly inefficient method of addressing the budget deficit.”<sup>206</sup> It noted that while furloughs are formally reductions in hours worked, they also operate as wage reductions.<sup>207</sup> The study explained that wage reductions have long been uncommon in recession because reducing wages can lead to a loss in productivity that surpasses the savings gleaned.<sup>208</sup> Wage reductions lead to losses in productivity for three reasons. First, they affect employee morale, making workers less likely to perform their job well.<sup>209</sup> One commentator noted that some employees would actually prefer a permanent layoff to the continuing frustration of performing the same job duties for less pay.<sup>210</sup> Second, they create a higher turnover of employees, forcing employers to spend money to hire and train new workers.<sup>211</sup> Third, employers lose their most productive workers because these workers have greater opportunities for outside advancement.<sup>212</sup> Employers have an increased incentive to retain the most productive workers during difficult economic periods.

The Berkeley study ultimately concluded that Governor Schwarzenegger’s across the board furlough of state employees saves little money in the long run.<sup>213</sup> The study criticized Governor Schwarzenegger’s decision to furlough all state employees, regardless of funding source.<sup>214</sup> Rather than limiting the furloughs to departments and positions subsidized by the General Fund,<sup>215</sup> the Governor’s furloughs reached employees subsidized by special funds (which

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205. KEN JACOBS, UC BERKELEY CTR. FOR LABOR RESEARCH & EDUC. POLICY BRIEF, *THE HIGH COST OF FURLOUGHS* (2009), <http://laborcenter.berkeley.edu/californiabudget/furloughs09.pdf>.

206. *Id.* at 1.

207. *Id.* at 3.

208. *Id.*

209. *Id.*

210. Green, *supra* note 179, at 1152.

211. JACOBS, *supra* note 205, at 3.

212. *Id.*

213. *Id.* at 7.

214. *Id.* at 2–3.

215. CAL. GOV’T CODE § 29301 (West 2008) provides: “The general fund consists of money received into the treasury and not specifically appropriated to any other fund.” California’s general fund finances most of the State’s expenditures. See *Description of Fund Classifications in the Treasury*, CAL. DEP’T OF FIN., [http://www.dof.ca.gov/budgeting/budget\\_faqs/documents/FundClassifications.pdf](http://www.dof.ca.gov/budgeting/budget_faqs/documents/FundClassifications.pdf) (last visited Aug. 25, 2011). Notably, the general fund provides the resources for the State’s non-revenue generating departments. See JACOBS, *supra* note 205, at 2.

are revenue-generating and self-supporting) and the federal government.<sup>216</sup> Targeting non-General Fund workers creates significant costs to the General Fund. The Berkeley study projected that the furloughs would result in losses due to state workers paying less into state income taxes, reduced revenue collection due to cuts to the Franchise Tax Board and Board of Equalization, and losses in revenue to the California Public Employees' Retirements System ("CalPERS") as a result of state employees making lower contributions.<sup>217</sup> Additional costs to the General Fund include reduced fee collections by other departments, litigation challenging the furloughs, and the cost of hiring outside contract workers to compensate for time lost to furloughs.<sup>218</sup> When combined, these costs would offset a significant part of the savings.<sup>219</sup>

Numerous alternatives existed that would have dealt more equitably with California's budget deficit. Most obviously, Governor Schwarzenegger could have engaged in the collective bargaining process to find solutions to lessen the hardship on state workers. The unions likely would have been willing to make concessions if they had been allowed to participate in the decision making process to decide if and how to implement cost cutting measures. SEIU claimed that its efforts to get information about the need for spending restrictions were futile.<sup>220</sup> The union claimed that the DPA knew of the impending crisis since August of 2008 and "squandered multiple opportunities . . . to find creative solutions to lessen the impact on state workers."<sup>221</sup> SEIU's willingness to compromise is not merely speculation: in February 2009 the union negotiated a contract with Governor Schwarzenegger for the 2009–2010 fiscal year that included one monthly furlough day.<sup>222</sup> Though SEIU's members ratified the contract, the Governor later rejected it.<sup>223</sup> This option would have been

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216. *Id.* at 3.

217. *Id.* at 5.

218. *Id.*

219. *Id.* For the FY 2009–10 furloughs, the study estimates a reduction in wages and benefits of \$2.01 billion for 193,000 workers over the course of the year, with a net savings of only \$236 million to the General Fund. *Id.* at 1.

220. See *Unions Challenge Furlough and Layoff Order*, *supra* note 186, at 42 ("The union also charges that DPA gave an inadequate response when Local 1000 asked for information about the need for the spending restrictions.")

221. *Id.*

222. JACOBS, *supra* note 205, at 3.

223. *Id.* In July 2009 Governor Schwarzenegger implemented a third monthly furlough day. *Id.* The Berkeley study, focusing on the Governor's three-day-a-month furlough, found that if state workers were furloughed one rather than three days a month, the medium-

preferable to the unilaterally imposed furloughs because it would have generated far less opposition. Additionally, medium-term net savings to the General Fund would have been greater with a single monthly furlough day, due to the smaller drop in revenue in subsequent years from a single furlough day.<sup>224</sup>

Governor Schwarzenegger could have also explored the possibility of *voluntary* reduced work time or paid leave as a means of cutting costs.<sup>225</sup> CASE demonstrated its willingness to explore voluntary reduced work time as an alternative to mandated furloughs.<sup>226</sup> Another option would be to limit furloughs to departments and positions that are subsidized by the General Fund and therefore not revenue producing.<sup>227</sup> This would burden significantly fewer state employees, while simultaneously reducing the economic impacts to the General Fund. Still another alternative would be to increase taxes as Democrats pushed for prior to the Executive Order. Though raising taxes is admittedly a less politically expedient alternative, “[w]here reasonable alternatives exist for addressing the fiscal needs of the State which do not impair contracts, action taken that does impair such contracts is not an appropriate use of State power.”<sup>228</sup>

## Conclusion

Looking at *Professional Engineers* through the lens of the Contract Clause demonstrates that the unions would have prevailed on their Contract Clause challenge if the claim had been properly asserted before the California Supreme Court. The analysis also illustrates how honoring the Contract Clause would have been advantageous for both the unions seeking to implement their rights and the California government officials seeking to remedy the state’s budget problems. Instead, Governor Schwarzenegger violated his contractual obligations by making an end run around collective bargaining. Both the Governor and the Legislature failed to demonstrate that they considered policy alternatives before impairing their own contracts. The result was public employee outrage, unnecessary and costly litigation, and

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term net savings to the General Fund would be \$256 million, or \$20 million more, with a single monthly furlough day than with three furlough days. *Id.* at 1.

224. *Id.*

225. See Green, *supra* note 179 at 1170–71.

226. Prof’l Eng’rs in Cal. Gov’t v. Schwarzenegger, 239 P.3d 1186, 1219 n.35 (Cal. 2010). In its MOU, CASE explicitly stated its willingness to experiment with *voluntary* reduced work time as an alternative to laying off employees. *Id.*

227. See JACOBS, *supra* note 205, at 7.

228. Donohue v. Paterson, 715 F. Supp. 2d 306, 322 (N.D.N.Y. 2010).

discord among California government officials. Had the Governor honored the Contract Clause, the result would have been a more collaborative, better informed strategy for addressing California's budget crisis. California instead wasted state funds to defend an ineffective and highly contentious policy.

Where do California's public employees go from here? *Professional Engineers* plaintiffs will likely not pursue a federal Contract Clause challenge. One of the reasons the unions initially declined to raise the unconstitutional impairment of contract claim was that the MOUs affected by the Governor's Order had expired. Courts are divided on the issue of whether expired labor contracts are protected by the Contract Clause.<sup>229</sup> Even though the MOUs in *Professional Engineers* were technically expired, the contracts continued to bind the parties by virtue of the continuing benefits provision of the Dills Act. Indeed, Governor Schwarzenegger conceded this issue, and the California Supreme Court agreed that "[a]lthough each of the MOUs had expired . . . the terms of the expired MOU remained in effect, because the parties had not reached an impasse in their negotiations over a new MOU."<sup>230</sup>

Looking forward, California public employees have returned to the bargaining tables. They hope that Governor Jerry Brown, who thirty years ago signed the law that gave state workers the right to collectively bargain, will respect their rights.<sup>231</sup> Several unions, including PEEG, have recently reached agreements on new MOUs.<sup>232</sup> Cognizant of the state's continuing budget problems, the new MOUs make some

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229. See *Ass'n of Surrogates v. New York*, 588 N.E.2d 51 (N.Y. 1992). New York's highest court found that a continuing benefits provision, similar to the California continuing benefits provision, should be construed to extend an expired collective bargaining agreement until a new agreement is negotiated. As such, the court found that the expired collective bargaining agreement constituted a valid and subsisting contract between the parties, subject to protection under the Contract Clause. *Id.* at 53. The court reasoned that "[t]o hold otherwise would mean that the State would be bound by the terms of an expired collective bargaining agreement only so long as it wished to be bound." *Id.* But see also *R.I. Bhd. of Corr. Officers v. Rhode Island*, 357 F.3d 42 (1st Cir. 2004). The court found that the employer's obligation to maintain the status quo arises under state labor law and not by contract. *Id.* at 47. A full discussion of whether expired MOUs trigger the protection of the Contract Clause is beyond the scope of this Comment.

230. *Prof'l Eng'rs*, 239 P.3d at 1219.

231. Jon Ortiz, *The State Worker: Clock is Ticking on Six Union Contract*, SACRAMENTO BEE (Feb. 3, 2011), <http://www.sacbee.com/2011/02/03/3373331/the-state-worker-clock-is-ticking.html>.

232. Tentative Agreement Between State of Cal. and Prof'l Eng'rs in Cal. Gov't (PEEG) Covering Bargaining Unit 9, Professional Engineers, Effective April 1, 2011 Through July 1, 2013, <http://www.dpa.ca.gov/bargaining/contracts/pdf/bu09/20110401-20130701/20110324-tentative-agreement.pdf>.

concessions, including a one day a month personal leave program which operates like a self-directed furlough.<sup>233</sup> The MOUs explicitly state that while the contract remains in effect, no additional furlough program may be implemented.<sup>234</sup> On May 16, 2011, the Legislature approved and Governor Brown signed Senate Bill 151,<sup>235</sup> which ratified and implemented the new MOUs.<sup>236</sup>

The Contract Clause remains a powerful tool for public employees working under collective bargaining agreements in states like Wisconsin.<sup>237</sup> Commentators believe that the pension provisions of Wisconsin Governor Scott Walker's Budget Repair Bill are ripe for Contract Clause challenges.<sup>238</sup> The impact of the pension provisions on Wisconsin public employee pension rights parallels the impact of the pay delay statutes at issue in *University of Hawaii* on Hawaii's public employees.<sup>239</sup> The Wisconsin pension provisions, which effectively cut two weeks of pay, will likely be found to substantially impair public employee contracts. Because Wisconsin is a party to the contract, a court

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233. Summary of Collective Bargaining Agreement for Bargaining Unit 9 at 2 (2011), <http://www.dpa.ca.gov/bargaining/contracts/pdf/bu09/20110401-20130701/20110324-summary.pdf>. The Personal Leave Program (PLP 2011) reduces pay by approximately 5%. *Id.*

234. *Id.*

235. S.B. 151, 2011–2012 Leg., Reg. Sess. (Cal. 2011). Consistent with existing law, this bill provides that provisions of the MOUs that require the expenditure of funds will not take effect unless funds for those provisions are specifically appropriated by the Legislature. *Id.* However, the bill makes an important departure. It does not mandate that the funds for these provisions be approved by the Legislature *in the Budget Act*. *Id.* This feature of the bill streamlines the appropriation process for state employee compensation because it bypasses the annual partisan budget battles. The bill states that these provisions will take effect even if the funds for the provisions are approved in other legislation. *Id.* If funds are not specifically appropriated by the Legislature, the bill requires that the state employer and the union meet and confer to renegotiate the affected provisions. *Id.*

236. Complete Bill History of S.B. 151, 2011–2012 Leg., Reg. Sess. (Cal. 2011), available at [http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb\\_0151-0200/sb\\_151\\_bill\\_20110516\\_history.html](http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0151-0200/sb_151_bill_20110516_history.html).

237. On June 14, 2011, the Wisconsin Supreme Court reversed a lower court ruling that enjoined the publication of the Governor's Budget Repair Bill because of alleged violations of Wisconsin's Open Meetings Law. State *ex rel.* Ozanne v. Fitzgerald, 798 N.W.2d 436, 445 (Wis. 2011). In a 4-3 decision, the Wisconsin Supreme Court held that the lower court judge did not possess jurisdiction to enjoin the legislative process and that she had exceeded her authority in prohibiting publication of the bill. *Id.* at 439. In a scathing dissent, Justice Abrahamson criticized the majority for "hastily reaching judgment" and writing an order "lacking reasoned, transparent analysis and incorporating numerous errors of law and fact." *Id.* at 451. Abrahamson also pointed out that the court improperly asserted original jurisdiction to issue a ruling in the case. *Id.* at 453.

238. Paul M. Secunda, *Constitutional Contracts Clause Challenges in Public Pension Litigation*, 29 HOFSTRA LAB. & EMP. L.J. (forthcoming 2011) (manuscript at 42), available at <http://ssrn.com/abstract=1806018>.

239. *Id.* at 43.

addressing the issue will closely scrutinize the pension laws.<sup>240</sup> Under heightened scrutiny, Wisconsin's \$150 million budget deficit will likely not constitute a legitimate public purpose justifying the substantial contractual impairment.<sup>241</sup>

While the outcome for public employees in Wisconsin is difficult to predict—given the political pressures from the executive and legislative branches—the lesson learned from both Wisconsin and California is clear. In desperate economic times, the Contract Clause should serve as an important reminder that the politically expedient choice is not always the best one. Though it requires more effort to thoroughly analyze the range of policy alternatives when addressing a fiscal crisis, invoking the Contract Clause will result in a better outcome for both state governments and public employees.

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240. *Id.* at 45.

241. *Id.* at 44, 46.