

# TOWARD A DEFINITION AND CRITIQUE OF RETROACTIVITY

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A retroactive law is truly a monstrosity. Law has to do with the governance of human conduct by rules. To speak of governing . . . today by rules that will be enacted tomorrow is to talk in blank prose.<sup>1</sup>

## I. INTRODUCTION

Among lawyers, discussions about retroactive laws generally focus on ways to challenge such laws, whether through the Takings, Contracts, Due Process, Bill of Attainder or Ex Post Facto Clauses. Conversely, many academics consider the difficulty of defining retroactive laws and the fact that essentially all new laws upset settled expectations, and they treat retroactive laws as merely a more efficient means of law-making. Before we launch into a learned discussion of the implications of *Eastern Enterprises*<sup>2</sup> and *Winstar*,<sup>3</sup> however, it behooves us to ask: What is a retroactive law, and what is so bad about retroactive laws anyway? As we shall see, the second question is considerably easier to answer than the first.

As Lon Fuller accurately states in the quote set forth above, Anglo-American tradition is profoundly hostile to “retroactive” laws. This hostility is embodied in our Constitution, most notably in the prohibitions on ex post facto laws—although not just

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1. LON L. FULLER, THE MORALITY OF LAW 53 (1964).
2. *Eastern Enters. v. Apfel*, 524 U.S. 498 (1998).
3. *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

there, of course.<sup>4</sup> Not changing the rules after the game has been played is considered an element of fundamental fairness. Books on child training, on how to improve marriages, and on effective management all emphasize the importance of establishing a rule, sticking with it, and providing notice before changing it.<sup>5</sup>

A passage in H. Clay Trumbull's 1890 *Hints on Child Training* exemplifies this sentiment. He writes that

[a]s a rule, a child ought not to be punished except for an offense that, at the time of its committal, was known by the child to be an offense deserving of punishment. It is no more fair for a parent to impose a penalty to an offense after the offense is committed, than it is for a civil government to pass an *ex post facto* law, by which punishment is to be awarded for offenses committed before that law was passed.<sup>6</sup>

The problem, though, is that in one sense almost all legislation can be characterized as retroactive, if by that notion we mean a law that may surprise people who have made decisions in reliance on the existing legal regime. The technical reason for this verity is that the operation of almost all legislation depends on antecedent facts. As a result, legislation inevitably has the potential to upset settled, investment-backed expectations.

To take a basic example, a real estate tax increase that operates prospectively raises the taxes on a house that a taxpayer bought in the past, perhaps in the expectation that he or she was buying in a low-tax jurisdiction. The moment that the legislature raises the tax on the house, it is worth less because the market takes account of the value of the regulatory change as soon as it becomes publicly known. To take just one more example, consider a prospective repeal of the tax exemption for interest on an outstanding municipal bond.<sup>7</sup> Without referring to the past or changing the past legal consequences of any past event, the law has substantially affected the existing interest of the

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4. U.S. CONST. art. I, § 9, cl. 3; *id.* § 10, cl. 1; *see id.* amend. V.

5. *See, e.g.*, H. CLAY TRUMBULL, *HINTS ON CHILD-TRAINING* 215 (1890).

6. *Id.* at 215.

7. *See* Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47, 57-58 (1977).

homeowner or taxpayer.<sup>8</sup> Professor Jill Fisch puts it simply: Prospective laws "in fact affect prior transactions."<sup>9</sup>

Similarly, as Professors Douglas Kmiec and John McGinnis have noted, "[a]lmost all laws operate retrospectively in that they must defeat the subjective expectations of those who planned their conduct according to the existing law."<sup>10</sup> Indeed, the twentieth-century legal scholar Fuller says that "[i]f every time a man relied on existing law in arranging his affairs, he were made secure against any change in legal rules, the whole body of our law would be ossified forever."<sup>11</sup> Even the most conservative among us concede the importance of accommodating some legal change. Professor David Slawson is thus correct in concluding that "[r]eliance on existing rules . . . must be sacrificed to some extent to the need for change."<sup>12</sup>

New laws must always be read in light of existing laws. When a new law impinges on interests created under an old law, which law should be followed? All the interests created under the old law cannot be respected, or legal change would be impossible. But fundamental fairness requires that reasonable expectations be preserved and notice be given of the effect of new laws. Fairness may also require compensation to parties whose expectations are thwarted. This is, of course, where the Takings Clause comes in.

For centuries, courts, legislators and commentators have wrestled with the problem of precisely how to designate the point at which a law is sufficiently harmful to existing interests so that it merits being classified as "retroactive." Defining a law as retroactive has rarely ended the analysis, however. The de-

8. See *id.* at 57-59.

9. Jill E. Fisch, *Retroactivity and Legal Change: An Equilibrium Approach*, 110 HARV. L. REV. 1055, 1067 (1997).

10. Douglas W. Kmiec & John O. McGinnis, *The Contract Clause: A Return to the Original Understanding*, 14 HASTINGS CONST. L.Q. 525, 528 (1987).

11. FULLER, *supra* note 1, at 60; Bryant Smith, *Retroactive Laws and Vested Rights*, 5 TEXAS L. REV. 231, 233 (1927)

("[I]f . . . a law is retrospective which extinguishes rights acquired under previously existing laws, then . . . all laws of any kind whatsoever, are retrospective. There is no such thing as a law that does not extinguish rights, powers, privileges, or immunities acquired under previously existing laws. That is what laws are for.")

12. W. David Slawson, *Constitutional and Legislative Considerations In Retroactive Lawmaking*, 48 CAL. L. REV. 216, 226 (1960).

bate then becomes whether such laws, or which sub-category of retroactive laws, should be prohibited or give rise to a claim for compensation.

The ultimate question in dealing with the problem of retroactive legislation is, therefore, to define when a law is sufficiently different from other laws, despite their (almost inevitable) retrospective effects, to merit the label "retroactive." Secondly, we must identify which of those are *illegitimately* retroactive laws. The first part of this inquiry is definitional: When is a law retroactive? The second is normative: Is the retroactive law justified? The answer to the second question turns on yet another normative inquiry—namely, in Slawson's terms, to what extent is one willing to sacrifice "[r]eliance on existing rules" to accommodate "the need for change?"<sup>13</sup>

This Article will address that vexing question by, first, seeking to distinguish among forms of laws. Next, in an effort to answer the second question—which (retrospective) laws are illegitimately retroactive—it will briefly examine the arguments against retroactive legislation. Such inquiry suggests that there may be some few laws that are retroactive in form but nonetheless, justifiable. My broader (normative) conclusion, though, is that the overwhelming majority of laws that are retroactive in form are unjustifiable. The courts, however, have by no means shared that perspective.

## II. WHEN IS LEGISLATION RETROACTIVE?

For at least two reasons, deciding whether a law is or is not retroactive can be quite difficult.<sup>14</sup> The first reason is that, given the retrospective nature of almost all legislation, affixing the label "retroactive" to a law is a question of degree and requires balancing the authority of an earlier legislature against that of a later one. To illustrate: Assume that Congress were to determine that all FCC licenses should run for twenty-year terms. Next assume that the subsequent Congress were to decide that it

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13. *Id.*

14. FULLER, *supra* note 1, at 59 (stating that in analyzing retroactive legislation, "the most difficult problem of all [is] knowing when an enactment should properly be regarded as retrospective").

wants to reclaim the spectrum faster, so that it may auction off that spectrum. The second Congress therefore proposes to limit existing licenses to five-year terms. The conflict between the preferences of the first and second Congresses in this hypothetical case may be called, in Professor Julian Eule's phrase, a "temporal" conflict of laws between the pronouncements of an earlier legislature and those of a later legislature.<sup>15</sup>

Eule properly notes that if the first Congress's decision were treated as immutable, we would be denying the next Congress the ability to implement its own views of proper public policy.<sup>16</sup> In one sense, this is unremarkable—a later Congress must always deal with the world as it finds it, based in part on what past Congresses have done. Our system of government is not a pure democracy, where the peoples' representatives can radically reshape the law and rights created under that law as soon as they come into power. This conflict illustrates, though, that the concept of immutability, which Eule calls "entrenchment," and the power to adopt retroactive laws "lie along a single time line."<sup>17</sup> "At some juncture, a prohibition against retroactive law-making becomes entrenching."<sup>18</sup>

The second problem with many of the classic definitions is that they fail to distinguish between retroactive laws, on the one hand, and illegitimate laws, on the other. These definitions often conflate the definitional and normative questions above and wield the term "retroactive" as a pejorative conclusion, assuming that a retroactive law is per se illegitimate. To illustrate, writing "on circuit" in 1814, Joseph Story provided the classic statement on statutory retroactivity.<sup>19</sup> In *Society for the Propagation of the Gospel v. Wheeler*,<sup>20</sup> he defined a law as retroactive where it "takes away or impairs vested rights acquired under existing law, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations

15. Julian N. Eule, *Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity*, 1987 AM. B. FOUND. RES. J. 379, 443 (1987).

16. *Id.*

17. *Id.*

18. *Id.*

19. *Society for the Propagation of the Gospel v. Wheeler*, 22 F. Cas. 756, 767 (C.C.D.N.H. 1814) (No. 13,156).

20. *Wheeler*, 22 F. Cas. at 767.

already past." The problem with this definition, in short, is that it is circular—turning on whether a right is or is not considered "vested."<sup>21</sup>

Almost from the moment of Story's pronouncement, commentators have sought to understand and apply it. For example, one nineteenth-century lawyer defined a retroactive law as one "which changes or injuriously affects a present right; by going behind it and giving efficacy to anterior circumstances to defeat it, which they had not when the right accrued."<sup>22</sup>

Neither of these classical definitions, however, clarifies the problem of differentiating between prospective laws, which almost inevitably have a retrospective effect, and retroactive laws. To illustrate, Professor Bryant Smith early in this century described a retrospective law as one that "extinguishes or impairs legal rights already acquired by the individual under the laws previously existing."<sup>23</sup> But, as noted, a prospective tax increase can be said to "impair legal rights" to the same extent as a law changing the terms of contracts currently in effect, which would surely be considered an illegitimately retroactive law.

That retrospectivity is a question of degree does not mean, however, that we cannot identify categories of laws that are unambiguously retroactive. Laws can be usefully divided into two basic categories, each having two subcategories.

### A. *Retroactive Laws*

Retroactive laws are all those that explicitly refer to and change the past legal consequences of past behavior. Such laws can, in turn, be classified into two subcategories. The first type of retroactive law, which might be labeled *strongly retroactive*, consists of laws that are, on the face of the statutes, "effective" even before the date of their enactment.<sup>24</sup> Such laws are easy to identify and most often come up in tax context. For example, Jerry Carlton was an estate executor who in 1986 responded to

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21. See DANIEL TROY, *RETROACTIVE LEGISLATION* 77-79 (1998).

22. Smith, *supra* note 11, at 233-34 (quoting *Poole v. Fleeger*, 36 U.S. 185, 198 (1837)).

23. Smith, *supra* note 11, at 232.

24. Stephen R. Munzer, *Retroactive Law*, 6 J. LEGAL STUD. 373, 383 (1977).

a tax deduction that Congress had specifically created to encourage people to sell a company's stock to that company's employee stock ownership plan ("ESOP").<sup>25</sup> Mr. Carlton sold the stock to the ESOP for a loss, in order to get the benefit of the tax deduction.<sup>26</sup> Congress then not only repealed the deduction, but it also applied that repeal retroactively, costing the estate more than \$600,000.<sup>27</sup> Such strongly retroactive laws are so obviously offensive that, outside of the tax context, legislatures do not often pass them.

A second subcategory of retroactive laws are those that operate forward from the date of enactment but explicitly make reference to and change the legal consequences of acts that took place in the past. These can be labeled *weakly retroactive laws*.<sup>28</sup> Weakly retroactive laws operate forward but explicitly change the consequences of past behavior. The best example is the so-called Superfund law, which Congress passed in 1980 to deal with hazardous waste sites, as it had been interpreted by courts.<sup>29</sup> This law, officially known as the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA"),<sup>30</sup> imposes massive retroactive liability on individuals or companies who generated, delivered or owned waste that is found at a contaminated site.<sup>31</sup> Courts have also interpreted CERCLA as establishing a strict liability scheme.<sup>32</sup> As one Superfund scholar describes it, this means that potentially responsible parties, known as PRPs, are "retroactively liable for the disposal of hazardous waste that took place thirty years earlier, even if the disposal was done in a 'state of the art' manner that was consistent with applicable laws."<sup>33</sup>

A forerunner of CERCLA was the Federal Coal Mine Health

25. *United States v. Carlton*, 512 U.S. 26, 28 (1994).

26. *Carlton*, 512 U.S. at 28.

27. *Id.* at 28-29.

28. Munzer, *supra* note 24, at 383.

29. 42 U.S.C. §§ 9601-9675 (1994).

30. *Id.*

31. *See id.*

32. *United States v. Monsanto Co.*, 858 F.2d 160, 167 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989).

33. David H. Topol, *Hazardous Waste and Bankruptcy: Confronting the Unmasked Questions*, 13 VA. ENVTL. L.J. 185, 190 (1994). *See generally* RICHARD L. STROUP, SUPERFUND: THE SHORTCUT THAT FAILED 6 (PERC Policy Series 1996).

and Safety Act of 1969.<sup>34</sup> That act required mine operators to compensate current miners, former miners and the survivors of miners for death or total disability caused by pneumoconiosis, so-called black lung disease.<sup>35</sup> Mine owners had to pay this compensation even if the miners had left their employ years before the implementation of the Act.<sup>36</sup> Similarly, the law at issue in *Eastern Enterprises* would seem to fall into this category.

An oft-cited example helps to distinguish between strongly and weakly retroactive laws. Assume that a passed law retroactively sought to validate a previously invalid marriage.<sup>37</sup> If that law operates as if the new rule had always been the law and the affected marriage, as a result, is considered valid from its inception, then the law is strongly retroactive.<sup>38</sup> If the marriage is deemed valid only as of the date of the law's enactment, it is weakly retroactive.<sup>39</sup> This Article uses the label "retroactive" to refer to both categories of laws; if it explicitly refers to the past, it is retroactive.

A normative view is that the only type of strongly or weakly retroactive laws that generally are justified are "curative" laws. Such legislation is designed to restore what was believed to be the status quo. Curative legislation serves many of the same values as a limitation on retroactive lawmaking—most notably, protecting expectations—and has generally been upheld by courts.<sup>40</sup>

To illustrate, consider a law providing that a marriage is lawful only if the marriage certificate has affixed to it a special stamp provided by the state. Suppose, as a result of a breakdown at the state printing office, these stamps are not ready when the law goes into effect. This stamp requirement is not

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34. 30 U.S.C. §§ 801-960 (1994).

35. *See id.*

36. *See id.*

37. Munzer, *supra* note 24, at 381-82.

38. *Id.* at 383.

39. *Id.*

40. Slawson, *supra* note 12, at 238; see Laura Ricciardi & Michael B.W. Sinclair, *Retroactive Civil Legislation*, 27 U. TOL. L. REV. 301, 345 (1996) (giving, as a modern example of a curative law, Congress' enactment of the Portal-to-Portal Act of 1947, which had retroactive effect and which changed a surprising judicial interpretation of a statute on which no one had relied).



well known, and people get married without having their certificate stamped. Few would object to legislation conferring validity on these otherwise-void marriages, even though such a law would unquestionably be retroactive.<sup>41</sup> Other than this category of laws, though, it is hard to conceive of many legitimate justifications for either strongly or weakly retroactive legislation.

*Retrospective Laws.* Laws affecting past events, which is to say almost all laws, will be referred to as retrospective.<sup>42</sup> Such laws can be divided into two categories as well. The most difficult category of laws to classify and deal with are laws that do not mention prior events but that change the legal consequences of such events. Such legislation is *impliedly retroactive*. Claims that a law is impliedly retroactive will most often arise in the application of a law of general applicability to past events. The law at issue in *United States v. Winstar* would seem to fall into this category.

To illustrate, imagine a law providing a defense in future contract actions to all those who claim that they did not read an agreement. Such a law is prospective and presumably valid with respect to an individual who enters into an agreement after the law has been passed. Once this law has been passed, contracting parties are on notice that they must ensure that their contracting partner has actually read the agreement.

But what about the individual who entered into an agreement before this law was passed? Although the law may not expressly refer to past events, applying this law to parties who acted in the past under a different legal regime raises serious questions of fairness. The presumption of prospectivity is most helpful in dealing with this (large) category of laws. By assuming that the law was intended to be applied prospectively only, even if the law does not say so explicitly, adherence to this presumption wards off many close questions.

The remaining class of laws—into which almost every law falls—is ostensibly “prospective” laws. As noted, these laws may upset settled, investment-backed expectations, although they do

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41. This hypothetical is used by FULLER, *supra* note 1, at 53-54.

42. Some commentators have sought to define a technical distinction between retroactive and retrospective laws. Most do not. See, e.g., Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 692 n.1 (1960).

not change the *legal consequences* of past actions.

This rules-based approach is akin to and builds on Justice Antonin Scalia's definition of retroactivity. Scalia distinguishes primary and "secondary" retroactivity, which roughly correlate with the categories of retroactive and retrospective laws noted above.<sup>43</sup> The example he provides is instructive:

The Treasury Department might prescribe, for example, that for purposes of assessing future income tax liability, income from certain trusts that has previously been considered non-taxable will be taxable—whether those trusts were established before or after the effective date of the regulation. That is not retroactivity in the sense at issue here, i.e., in the sense of altering the *past* legal consequences of past actions. Rather, it is what has been characterized as "secondary" retroactivity. . . . "A rule with exclusively future effect (taxation of future trust income) can unquestionably *affect* past transactions (rendering the previously established trusts less desirable in the future)."<sup>44</sup>

In a later case, Scalia expanded on this definition, stating that "[t]he critical issue . . . is not whether the rule affects 'vested rights,' or governs substance or procedure, but rather what is the relevant activity that the rule regulates."<sup>45</sup> Professor Nelson Lund explains that, under this approach, a statute imposing new substantive obligations "would be considered retroactive if it applied to conduct predating the statute's enactment. A statute establishing a new rule of evidence, however, regulates the conduct of trials; it would therefore be considered retroactive only if applied to evidence previously admitted or excluded from a trial."<sup>46</sup>

This distinction is worth noting because of its proper focus on a change to the "*past* legal consequences of past actions" and on whether the individual relied on the prior rule.<sup>47</sup> But the

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43. *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 219-20 (1988) (Scalia, J., concurring).

44. *Bowen*, 488 U.S. at 219-20.

45. *Landgraf v. USI Film Prods.*, 511 U.S. 244, 281-86 (1994) (Scalia, J., concurring).

46. Nelson Lund, *Retroactivity, Institutional Incentives, and the Politics of Civil Rights*, 1995 PUB. INTEREST L. REV. 87, 94.

47. *Bowen*, 488 U.S. at 219-20 ("A rule that has unreasonable secondary retroactivity—for example, altering future regulation in a manner that makes worthless substantial past investment incurred in reliance upon the prior rule—may for that

category of "secondary" retroactivity is often not helpful, in that almost every law "affects past transactions."

The alternative to the rule-based approach described above is generally a multifactor analysis that empowers courts to define and presumably, under certain circumstances, invalidate legislation that goes "too far." For example, Professor Jill Fisch recently proposed in the *Harvard Law Review* that legislation be invalidated as unfairly retroactive if it upsets a "stable" equilibrium.<sup>48</sup> Her preferred approach would be that "[i]f a rule has persisted over time, if it has been applied in a range of cases, and if its contours have been set by a high lawmaking authority, then the rule is more difficult to change."<sup>49</sup>

Fisch acknowledges that "[t]hese factors do not establish a bright-line rule."<sup>50</sup> She views this as a strength of her analysis because retroactivity, she claims; is not binary but is rather a question of degree and because a rule-based approach follows "arbitrarily precise criteria."<sup>51</sup> She also rejects the type of rule-based formulation stated above "that predates the adoption of a legal change without specifying where this conception comes from."<sup>52</sup>

Other commentators also suggest a similar balancing-type inquiry in assessing whether legislation is unlawfully retroactive. For example, Professor Charles Hochman urged courts to focus on "the nature and strength of the public interest served by the statute, the extent to which the statute modifies or abrogates the asserted preenactment right, and the nature of the right which the statute alters."<sup>53</sup>

A full defense of a rule-based approach over balancing tests and multifactor analyses is beyond the scope of this Article.<sup>54</sup> Suffice it to say that rule-based approaches, although they certainly do not eliminate all close questions, more narrowly constrain the discretion of judges. They also increase predictability,

reason be 'arbitrary' or 'capricious' . . . and thus invalid.") (Scalia, J., concurring).

48. Fisch, *supra* note 9, at 1103.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at 1071.

53. Hochman, *supra* note 42, at 697.

54. For such a defense, see Antonin Scalia, *The Rule of Law as a Law of Rules*,

56 U. CHI L. REV. 1175 (1989).

uniformity and legitimacy.<sup>55</sup> Thus, such an approach is preferable to the more open-ended balancing tests.

*B. Why Do We Care? Moral and Economic Arguments Against Retroactive Legislation*

Retroactive laws offend for both moral and practical reasons. Those who defend retroactive legislation give short shrift to property rights, expectation interests and the ability of humans to make informed choices.

III. MORAL ARGUMENTS AGAINST RETROACTIVITY

The rules generated by a legal system have legitimacy only if that system is just. Retroactive laws are generally perceived by our society as unjust. This perception rests on our everyday experience. From early on, we learn not to change the rules in the middle of the game. We protest if our parents punish us without warning. We quickly come to dread unwelcome surprises. We expect warnings before dramatic events upset our expectations. And we mold our conduct based on the laws as we know and understand them.

Our culture manifests this expectation in many ways. The *New Testament* teaches that "Where no law is, there is no transgression."<sup>56</sup> As noted, self-improvement books repeatedly emphasize the importance of choosing a principle, sticking with it, and providing notice before changing it. This idea of notice and of not applying rules post hoc is embedded in our fundamental law. As Oliver Wendell Holmes observed in *The Common Law*:

But while the law is thus continually adding to its specific rules, it does not adopt the coarse and impolitic principle that a man always acts at his peril. On the contrary, its concrete rules, as well as the general questions addressed to the jury, show that the defendant must have had a least a fair chance of avoiding the infliction of harm before he becomes answerable for such a consequence of his conduct.<sup>57</sup>

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55. *Id.* at 1178.

56. *Romans* 4:15.

57. OLIVER WENDELL HOLMES, *THE COMMON LAW* 163 (1949).

Plainly, a defendant has not had, in Holmes' terms, "a fair chance of avoiding the infliction of harm" if no notice has been given to him of the consequences of his conduct.<sup>58</sup>

The concept of notice is fundamental to fairness and to the rule of law. A retroactive law is unfair precisely because it does not afford the affected individual notice about the rule that will be applied. As Benjamin Cardozo said, "[l]aw as a guide to conduct is reduced to the level of mere futility if it is unknown and unknowable."<sup>59</sup> Thus, when John Locke spoke of law in a civil society, he referred to "settled standing laws."<sup>60</sup> Or, as Dean Ronald Cass wrote, "[a] critical aspect of the commitment to a rule of law . . . is the promise that the government's force will be brought to bear on individuals—especially in criminal proceedings where that force is at its most fearsome—only after fair warning."<sup>61</sup>

The requirement that people be given notice of the legal implications of their behavior assumes that humans are, at least in part, moral actors, possessing free will.<sup>62</sup> It further assumes that we are capable not only theoretically of modifying our behavior depending on the rule of law, but also that we do so in fact. Were we incapable of making choices, such that our behavior was unaffected no matter what the prevailing rule of law, then notice of the content of that rule would be irrelevant.<sup>63</sup>

If human beings were not capable of moral choice or if they functioned without regard to the rule of law, then it would be irrational *not* to apply rule changes retroactively. To illustrate, suppose experience were to teach that a particular tax exemp-

58. *Id.*

59. BENJAMIN N. CARDOZO, *THE GROWTH OF THE LAW* 3 (1924).

60. JOHN LOCKE, *SECOND TREATISE OF GOVERNMENT* § 137, at 78 (1980).

61. Ronald A. Cass, *Judging: Norms and Incentives of Retrospective Decision-making*, 75 B.U. L. REV. 941, 954 (1995); Hochman, *supra* note 42, at 693 ("Perhaps the most fundamental reason why retroactive legislation is suspect stems from the principle that a person should be able to plan his conduct with reasonable certainty of the legal consequences.").

62. *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) ("[B]ecause we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly.") (Marshall, J.).

63. Slawson, *supra* note 12, at 224 (stating that a retroactive law "necessarily eliminates the possibility that its effects can be avoided by a choice of conduct").

tion ended up "costing" far more than was anticipated, thus increasing the budget deficit. If those who had structured their financial transactions to take advantage of that exemption would have made the exact same investment choices anyway, then that exemption should, rationally, be rescinded retroactively. But it is precisely because we cannot know whether the former assumption is true that retroactive changes in the law are considered unfair. In fact, experience teaches us that the tax exemption probably did influence the affected individual's investment decision.<sup>64</sup> Retroactive law-making thus contradicts our understanding of human beings as possessing free will or, at a minimum, as instrumentally rational creatures who change behavior in response to stimuli, including legal sanctions.

Notice is therefore fundamental to the rule of law, and not just for the reason that people are entitled to fair notice before the state subjects them to its power. Social order requires reliance.<sup>65</sup> Even a slave must be able to rely on a correlation between his or her own good behavior and his or her master's response. Without this correlation, there is no incentive to obey the master's commands. If the subjects of a state were to believe that the laws will be applied to them in a wholly arbitrary fashion, their incentive to comply with such laws would evaporate. Thus, avoiding retroactive legislation increases individuals' incentives to conform their behavior to the law, and it enhances the legitimacy of the legal system.

#### IV. PRACTICAL ARGUMENTS AGAINST RETROACTIVITY

There is another, more practical argument against retroactive legislation. As Professor Bryant Smith noted, retroactive laws, far more so than laws that apply prospectively, "may be passed with a knowledge of the precise conditions to which they are to apply and of the persons or classes on whom will fall whatever burdens they may impose. They expose the lawgiver to greater temptation to partiality and corruption."<sup>66</sup> Smith put it

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64. See, e.g., *United States v. Carlton* 512 U.S. 26 (1994); *United States v. Darusmont*, 449 U.S. 292 (1981).

65. Slawson, *supra* note 12, at 226 (discussing FULLER, *supra* note 1).

66. Smith, *supra* note 11, at 417.

another way: "A law for the future is impersonal; whereas a law for the past may be personal."<sup>67</sup> While some have argued that we are wiser in retrospect, a moral legal system should take account of the Hayekian critique that we often are not as wise as we think we are.<sup>68</sup> The nature of the rule of law is to substitute rules announced in advance for the judgment of men, particularly post hoc.

In accordance with this notion of the rule of law, the power to judge and to punish people for past acts is limited to those institutions that we deem less likely to be partial. As Nelson Lund has aptly noted, "[t]he authority to impose liability for completed conduct is a dangerous tool in the hands of politically responsive institutions."<sup>69</sup> By contrast, judicial rules are, at least in theory, created by a disinterested, apolitical body.<sup>70</sup> This difference, as Professor Slawson says, ostensibly "diminish[es] the chance that prejudice or other irrational factors will control the decision."<sup>71</sup>

Also, unlike judges, who under the Constitution are confined to adjudicating the cases or controversies brought to them, legislatures can set their own agenda. This power to adopt wide-ranging retroactive laws is quite dangerous.

Legislatures are subject to influence and capture by special interests groups. If retroactive legislation is permitted, a group that has "lost" a struggle for resources will have a powerful incentive to try to undo that loss in the legislature. If those that would pay the costs of that reallocation are not as clearly defined or as well organized as the afflicted group, the likelihood is high that the legislature will respond to that afflicted group, at substantial cost to the public interest.

67. *Id.*

68. F.A. HAYEK, *THE CONSTITUTION OF LIBERTY* 8, 29 (1960).

69. Lund, *supra* note 46, at 87.

70. Slawson, *supra* note 12, at 245.

71. *Id.*; see also *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 513-14 (1989) (Stevens, J., concurring) ("It is the judicial system, rather than the legislative process, that is best equipped to identify past wrongdoers and to fashion remedies that will create the conditions that presumably would have existed had no wrong been committed.").

## V. ECONOMIC ARGUMENTS AGAINST RETROACTIVITY

Retroactive legislation imposes economic costs on society by undermining predictability, or the ability to rely on expectations. As Gregory Sidak and Daniel Spulber note, "expectations determine decisions and actions in a market economy."<sup>72</sup> If expectations are ignored, predictability is gone. Yet, as Ron Cass points out, "[p]redictability allows adjustments of individual behavior that increase societal well-being; increased predictability lowers costs associated with a decision."<sup>73</sup> Retroactive legislation thus leads to erroneous and therefore inefficient value assessments.<sup>74</sup>

Predictability is essential to continuing investments in productive enterprises, as well as to the availability of insurance. Decisions whether to invest or to provide insurance rely on the probabilities of a loss and the potential range of such loss. Retroactive legislation undercuts this vital predictability, thereby expanding the range of possible outcomes, and thus harming society by suppressing investment.

Stated another way, retroactive legislation is a contingency for which it is very difficult, if not impossible, for a firm to plan. Such legislation almost defines opportunistic behavior by the government. Fear of post-investment opportunism by the government may well deter parties from relying on the government's promises as much as they should for the sake of efficiency. That fear would be heightened with respect to investments in assets that are most valuable in one specific setting or relationship.<sup>75</sup>

To illustrate, a firm might invest less than would be optimal in a particular plant if it fears that the government will revoke the plant's license to operate or will impose impediments to the distribution of products from that plant. Fearful of being held up by the government, a firm will, *ex ante*, invest less than it opti-

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72. J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851, 865 (1996).

73. Cass, *supra* note, 61, at 960.

74. *Id.* at 961 ("When decision-makers based their determinations on inaccurate value assessments, parties who cannot easily contract to reverse or modify such decisions are left with a result that is less valuable than an alternative outcome.")

75. Sidak & Spulber, *supra* note 72, at 104-08.



mally should. Alternatively, rational economic actors will demand higher returns on their riskier investments. Thus, the individual actors may not be harmed by such legislation, having factored that risk into their investment. But society would still be harmed because the net amount of investment in such a society would be less than that which is optimally efficient.

Uncertainty as to operative rules discourages capital investment, which can be amortized only over time. To give an extreme example, few companies are willing to invest in a country where their permission to operate may be revoked at any time and their property nationalized. Countries in which such governmental decisions have occurred have experienced a net decline in foreign investment.<sup>76</sup>

Pablo Spiller, who has extensively documented this phenomenon in developing countries, makes clear that if the country's safeguarding institutions (e.g., stable politics, independent judiciary, high growth rate, tradition of independent and professional regulatory agencies) are not sufficient to reduce the risk of administrative expropriation, then private investments in sectors with large economies of scale and sunk investments producing mostly for the local market will not be forthcoming.<sup>77</sup>

The easiest way for a government to expropriate a firm's sunk investments is via retroactive legislation. Thus, limiting or precluding this device is apt to increase, or at least to create the conditions for increased, investment.

Even a law that may be inefficient as a matter of social welfare may be "efficient" if it is well specified and known in advance. At the very least, such a law permits the parties to

76. See, e.g., *ASEAN Officials to Draw up Framework for Regional Investment Area*, DEUTSCHE PRESSE-AGENTUR, July 5, 1996, available in LEXIS, News, AllNews (describing investment area plan as protecting foreign assets from nationalization to attract more foreign investment); *New Government in Bangladesh: Restoring Confidence*, EIU BUS. S. ASIA, July 1, 1996 (noting that the 1971 Bangladesh government "was responsible for ruining the new-born country's economy through nationalization of all industries"); Clyde Mitchell, *The Current Landscape in Egypt*, N.Y.L.J., Mar. 20, 1996, at 7 ("Foreign investors responded [to strict regulation of ownership in 1958] by pulling out of Egypt and, consequently, foreign investment participation in the economy drastically declined.").

77. Pablo T. Spiller, *Institutions and Regulatory Commitment in Utilities' Privatization*, 2 INDUS. CORP. CHANGE 387, 393 (1997).

arrange their affairs accordingly, thus maximizing social welfare within the constraints of the law (that is, they can minimize the law's costs).

## VI. DEFENDERS OF RETROACTIVE LAWS

Some scholars believe that retroactive laws should not—and cannot—be analyzed differently from other laws. Their arguments can be summarized as follows:

*Circularity.* The argument against retroactive legislation is circular, these scholars maintain. If everyone understood at the outset that their expectations could be upset, these critics contend, then there would be no settled expectations, and therefore nothing would be wrong with retroactive legislation.<sup>78</sup>

*Similarity.* As has been noted, both laws that are nominally prospective and laws that are nominally retroactive can upset expectations.<sup>79</sup> Any differences in impact between nominally prospective and retrospective laws are differences in degree and not in kind.<sup>80</sup> Given that retroactive laws raise the same issues as other laws, some contend, there is no reason to distinguish between retroactive laws and other laws. Also, because the differences are of degree, no precise definitions of retroactive laws are possible.

*No economic difference.* Retroactive rules do not necessarily cost more than prospective laws. As Fisch points out, “[a] rule that retroactively imposes a million dollars in liability . . . for past pollution activities has the same wealth effect as the nominally prospective adoption of stricter emissions controls that reduce the value of the manufacturer’s factory by a million dollars.”<sup>81</sup>

*More efficient law-making.* Efficient law-making—that is, law-making that maximizes the net benefits of legal change—favors retroactive laws. As Fisch says, this notion is “based on the utilitarian conception of a net gain in social wel-

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78. See, e.g., Graetz, *supra* note 7, at 49-63.

79. See, e.g., *id.*

80. Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 511, 515-19 (1986).

81. Fisch, *supra* note 9, at 1069.

fare without regard for distributional issues."<sup>82</sup> The lack of regard for distributional issues means that, although there is a net social gain, there are also identifiable winners and losers when a law is applied retroactively.<sup>83</sup>

The distinction is based on a fiction: It is the fiction that people "know the law." Since most laws are applied without actual notice, which is the fundamental complaint about retroactive laws, why should retroactive laws be treated differently?

Although many of these arguments have force, ultimately they must be rejected. Taking these objections in order, the circularity argument presumes that there are no pre-existing property rights and other reliance interests—that is, that they are the creation of government. To state the extreme version of this argument, no one will expect to hold property if he or she is told that all property is subject to confiscation at any time. Such an argument is of dubious constitutional validity. The Constitution both presumes and protects private property rights. It is beyond the power of the government to define out of existence all expectation interests.

Second, although it is true that the differences between retroactive and retrospective laws are generally of degree, the legal system can and often does address such differences. To quote Lon Fuller, "[a]s with the other desiderata that make up the internal morality of the law, difficulties and nuances should not blind us to the fact that, while perfection is an elusive goal, it is not hard to recognize blatant indecencies."<sup>84</sup> The presence of close questions cannot shut down the enterprise.

There are key differences between prospective and retroactive legislation. Prospective legislation destroys the status quo, on which people rely in making everyday decisions, less often and to a lesser extent than do retroactive laws. Retroactive law-making is more unusual, thereby coming as a greater surprise.<sup>85</sup> Also, even if prospective legislation disrupts settled expectations, such laws generally offer a way out before imposing new liability. As Dean Cass has pointed out:

82. *Id.* at 1088.

83. *Id.*

84. FULLER, *supra* note 1, at 62.

85. Eule, *supra* note 15, at 439-40.

The distinction between retrospective and prospective decisions is important precisely because the effects of one are less binding. A penalty of any given magnitude is more threatening—in terms of its capacity to interfere with personal autonomy, disrupt existing plans, undermine settled expectations, and impose greater disutility on those whose plans and property are changed—when it is less easily evaded.<sup>86</sup>

To address the third argument, although the direct economic costs of retroactive and prospective laws may be the same, retroactive costs impose greater transition costs. A society in which retroactive legislation is routine will experience less investment than is economically efficient.

There are also important psychological differences between retroactive and prospective laws. Retroactive laws frequently remove benefits currently enjoyed, while prospective rules may cause opportunities to be forgone. This may be all the same as an economic matter, but every child knows the difference between the experience of having a toy taken away and that of not being given an additional toy.<sup>87</sup> At a minimum, the child deserves fair notice before being told that he or she will have to share the toy. Only if the child were given the toy illegally—for example, if his parent had stolen it—should the child's feelings be subordinated to the social need to uphold the rule of law. Failing to take these psychological effects into account can imperil the legitimacy of a legal regime.

Fourth, the argument that retroactive law-making is more efficient law-making assumes that legal change is positive and evolutionary. Public choice theory teaches us that legal change is often harmful, however. As Jonathan Macey has written, public choice teaches that legal changes are frequently the result of a process by which rules "seek to effectuate wealth transfers from societal groups that possess relatively little political power to other, more powerful, groups and coalitions."<sup>88</sup> This skepticism

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86. Cass, *supra* note 62, at 953.

87. Daniel E. Troy, *Toy Story*, THE NEW REPUBLIC, June 3, 1996, at 4 (letter to the editor).

88. Jonathan R. Macey, *The Internal and External Costs and Benefits of Stare Decisis*, 65 CHI.-KENT L. REV. 93, 98 (1989). See generally DANIEL A. FARBER & PHILIP P. FRICKEY, LAW & PUBLIC CHOICE 7 (1991) (surveying the findings of public choice theory).

has led to justifiable mistrust of retroactive law-making. Also, it is precisely the efficiency of retroactive laws in allowing a legislature to target winners and losers that can make such legislation unfair and potentially draconian.

Fifth, although it is certainly true that no one can know all of the law, people are aware of their legal obligations as a general matter. Drivers may not know every provision of the traffic code, but they know enough to understand in most circumstances what is right and wrong. In fact, there is no choice but to assume that people know the law, both for the application of the criminal law and to avoid accepting a principle that would allow all laws to be changed arbitrarily. Additionally where individuals have a particular interest in a matter, they are more likely to know the law.

Most fundamentally, those who defend retroactive legislation need to articulate forceful reasons why the need for legal change is so important that it should override the fairness concerns created by retroactive legislation. Those defending untrammelled change must explain why such extreme (and uncompensated) change is a positive good. Although those attacking retroactivity analysis have highlighted flaws in it, they have not explained why the entire enterprise should be abandoned.

The defenders of retroactive law-making fail to realize that restrictions on such law-making do not preclude legal change. They moderate it. To illustrate, the presumption of prospectivity guards against extreme legal change that thwarts settled expectations, in the absence of a clear societal (or, at the very least, legislative) consensus that such extreme change is necessary. The Takings Clause ensures that just compensation is paid for laws that upset such expectations. The Contracts, Ex Post Facto, Bill of Attainder, and Due Process Clauses guard against particular applications of certain defined forms of legal change.

## VII. WHERE THINGS STAND TODAY

Generally, Anglo-American law has sought to deal with retroactive laws in two ways. First, if at all possible, courts have tried to avoid the problem. Unless a statute expressly states an intention to apply to pre-enactment transactions, court traditionally apply the "presumption of prospectivity." Under this an-

cient presumption, law-makers are presumed to intend statutes to apply prospectively. Although effective in cases of ambiguity, this presumption does not actually constrain the legislature's power to adopt retroactive legislation, if it does so in clear terms.

Second, if the legislature has adopted a clearly retroactive law, courts have invalidated the legislative action on constitutional grounds, relying either on express constitutional provisions or on the ground that such a law was beyond the power of the legislature. The Constitution's best known bars to retroactive lawmaking are, of course, the Ex Post Facto Clauses. These Clauses, which expressly apply to both the federal and the state governments, provide that "[n]o . . . ex post facto Law shall be passed."<sup>89</sup> Their companion provisions, the Bill of Attainder Clauses, prohibit state legislatures and Congress from punishing particular individuals or classes of individuals for past behavior.

Other constitutional constraints on retroactive laws include the Contracts, Taking and Due Process Clauses. Article I, section 10 of the Constitution bans state passage of "any . . . law impairing the Obligation of Contracts."<sup>90</sup> The Fifth Amendment ensures that private property shall not "be taken for public use, without just compensation."<sup>91</sup> And the Due Process Clauses, of course, guarantee that life, liberty, and property shall not be deprived without due process of law.<sup>92</sup>

At least since the New Deal era, most of these constraints on the power of the legislature to adopt retroactive laws—particularly the Contract, Takings, and Due Process Clauses—have been narrowly construed. In some cases, the narrowing interpretations are of far more veritable origin. Most notably, few non-lawyers—and not many more lawyers—realize that the Ex Post Facto Clauses have been construed since (at least) the early part of the nineteenth-century as applying to criminal sanctions only. The Bill of Attainder clauses, which have not been used by the Supreme Court to invalidate a law since 1965, guard against only the most egregious invasions of

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89. U.S. CONST. art. I, § 9, cl. 3; *id.* art. I, § 10, cl. 1.

90. *Id.* art. I, § 10, cl. 1.

91. *Id.* amend. V.

92. *Id.*; U.S. CONST. amend. XIV.

personal liberty.

Thus, the current legal regime affords relatively meager constitutional protections against retroactive legislation. Moreover, especially since the 1960s and until a recent revival, courts had been diluting the presumption of prospectivity. Basically, since the New Deal era, the American legal system has overvalued change and given short shrift to settled expectations.<sup>93</sup>

Thus, jurists are caught between a document—i.e., the Constitution—and an older tradition that is profoundly hostile to retroactive laws. However, modern case-law is far more tolerant of retroactive legislation. Although recently that tolerance has moderated, judges facing even a clear example of a massive, retroactive liability—as was the case in *Eastern Enterprises*<sup>94</sup>—still wrestle with how to deal with the issue in light of modern case-law, and in light of modern assumptions about legislative power. It is no wonder that the Supreme Court split five to four in *Eastern Enterprises*.<sup>95</sup>

A word about that five to four split. Because I believe that retroactive legislation is almost always unfair, even though there may be cases where it is hard to define whether the application of a statute is retroactive, I am pleased to see courts more vigorously enforcing the Constitution's Takings and Contracts Clauses. These protections guard against the "overconsumption" of retroactive legislation by the legislature. I do not believe, however, that the courts can—or even should—be counted on to revive the earlier and much stricter prohibitions on retroactive laws. To illustrate, even in a case presenting a clear (at least to me) takings problem such as *Eastern Enterprises*, five Justices found that the Takings Clause did not apply to the legislation at issue.<sup>96</sup> Some may look to the holding of *Eastern Enterprises* as foreshadowing a revival of the strictures against retroactive legislation; I see it as a sign that the attempted renaissance of the Takings Clause must await a very different Supreme Court.

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93. As one legal scholar has put it, evolutionary theory incorrectly suggests "that the law is always improving. Every change is self-proclaimed to be for the better." Herbert Hovenkamp, *Federalism Revised*, 34 HASTINGS L.J. 201, 215-16 (1982) (book review).

94. *Eastern Enters.*, 524 U.S. at 498.

95. *Id.*

96. *Id.*

At this point, the best we can expect from the Court is a strong clear-statement rule ensuring that statutes are applied retroactively only when Congress has expressly provided that the applicability of its new rule should turn on past conduct.

I would like to see Congress establish mechanisms making the adoption of retroactive laws quite difficult, especially those laws that would explicitly change the past legal consequences of past behavior. In fact, the recent memory of President Clinton's tax hike has actually led to some congressional action to limit retroactive tax hikes. Most notably, at the beginning of the 104th Congress, the House of Representatives passed an internal rule declaring retroactive tax increases out of order.<sup>97</sup> Senator Paul Coverdell pushed a similar bar through a Senate committee.<sup>98</sup> Another proposal, the Common Sense Legal Reforms Act of 1995, would require the committee report on any legislation "of a public character" to specify "[t]he retroactive applicability, if any, of that bill or joint resolution."<sup>99</sup>

More important still is that a political consensus be forged against all retrospective legislation. Politicians should be encouraged to adopt truly prospective legislation only, and to make greater use of delayed effective dates and "grandfathering." "Some of this consensus already exists and is embodied in the Constitution. As the Framers well understood, the need for stability counsels in favor of making the act of legislating difficult."<sup>100</sup>

This consensus has to be reinvigorated, however. The case against retrospective legislation should not be hard to make: Everyone understands the unfairness of changing the rules in the middle of the game. But only if retrospective legislation is made an issue, and if politicians are held politically accountable for such legislation when they approve it, can the incidence of such legislation be dramatically diminished.

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97. H.R. Res. 6, 104th Cong. (1995) ("It shall not be in order to consider any bill, joint resolution, amendment, or conference report carrying a retroactive Federal income tax rate increase.").

98. S. 94, 104th Cong. (1995) (approved by Governmental Affairs Committee, May 16, 1996).

99. H.R. 10, 104th Cong. § 106(B) (1995).

100. U.S. CONST. art. I (bicameralism, presentment and enumerated powers of Congress); THE FEDERALIST, No. 51 (James Madison).



In sum, the issue of retrospective legislation squarely presents the need to balance stability and flexibility. Enamored of change, our legal system has for the past few decades insufficiently understood the importance of providing notice and protecting reliance interests. I hope that *Eastern Enterprises* and *Winstar* are part of a move back towards stability, but again, a change in the political consensus is needed before the Takings Clause guards against anything other than the most egregious cases of government expropriation through retroactive legislation.

