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Laying the Foundations for a Market Economy

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The political separation pursued by the American founding was sharp and violent. But the transition to an independent American legal order was far less so. Note, for instance, the continuity between two systems in Article XXV of the 1777 New York Constitution:

> And this convention doth further, in the name and by the authority of the good people of this State, ordain, determine, and declare that such parts of the common law of England, and of the statute law of England and Great Britain, and of the acts of the legislature of the colony of New York, as together did form the law of the said colony on [April 19, 1777] shall be and continue the law of this State, subject to such alterations and provisions as the legislature of this State shall, from time to time, make concerning the same.[1]

Nor was this the only way in which the new regime derived from the old. The American constitutional system ultimately contained many features that were partial departures from the English model (like having a president and not a king). But much of its federal system was an adaptation that put the federal government in the place of the English government and left most of the governing to the states, deploying only (what seemed at the time) enumerated powers to define the federal government's role.

This relatively smooth doctrinal transition makes it possible to examine the American system in light of the English one. Unsurprisingly, many

of the tensions evident in legal debates in Great Britain, which was in the midst of its first industrial revolution, carried over to the United States. This was especially true with what we would now call economic policy.

In the founding period (which for legal-history purposes we might say extends from 1776 to about 1835, with John Marshall's death), dealing with these issues was compounded by a set of conceptual obstacles that did not get resolved until the 19th century. Laissez-faire economics were at best in their infancy. The term "capitalism," with its largely negative connotations, also lay in the future.

The social welfare implications of competition versus monopoly were not yet worked out, so the defense of classical-liberal principles of limited government and strong property rights was captured largely in the term "commercial republic," which obviously understated the role that manufacturing, mining, and agriculture would play both during and after the founding period. It was therefore with a limited set of analytical tools that early Americans confronted many basic questions about the character of the commercial economy then emerging on both sides of the Atlantic.

At the heart of these tensions lay the constant struggle between protectionism and competition. And the nascent American political order addressed these tensions and that struggle in a complex way that would set the pattern for American economic debates ever since. That pattern is especially evident in the Constitution's structure and some early legal debates about its implementation.

The American Constitution was a charter in two major directions: Key structural provisions govern the relationship between the central government and the states on the one hand and between the divided powers in the federal government on the other. Further provisions gave protection to individual rights.

Most, but not all of these, were conducive to the market economy or capitalism as we now know it. But never in any simple way. And working out the place of markets, competition, and trade in the life of the new republic was a constant preoccupation of the courts in the

nation's first half century. This is evident in a broad range of cases and controversies but can be illuminated by considering a few key domains in particular.

Free Trade Across Jurisdictional Boundaries

One of the effective preconditions of an exchange economy is that it allows for free trade between willing partners wherever they are located. Within a given jurisdiction, there are usually few, if any, territorial obstacles to free trade. But when trade crosses any jurisdictional boundaries, the government with power to exclude outsiders also has the power to exclude trade.

The Constitution took active steps to prevent the balkanization of trade within the United States and with it the weakening of the commercial republic by mercantilist policies of the sort that Adam Smith so roundly attacked in the *Wealth of Nations*. Thus, Article I, Section 10 prohibits any state, without Congress's consent, from imposing a tax on any import or export, except as is "absolutely necessary" to run local inspection laws intended to prevent the movement of dangerous goods from foreign nations.[2]

In *Brown v. Maryland* (1827), Chief Justice Marshall rejected a Maryland scheme that did not impose such a tax on the imports but only on the importer when the goods in question exceeded $50 in value (a bit over $1,000 today). The chief justice stressed that the clause's purpose was to encourage harmony within the United States and with foreign nations.

His interpretation prevented a circumvention of the Constitution by shifting the tax from the good to the person: "There is no difference, in effect, between a power to prohibit the sale of an article and a power to prohibit its introduction into the country."[3] He then developed an "original packet" doctrine to set the time at which the goods were no longer insulated from local taxation, by being mixed in with other goods within a given state.

By way of analogy, the later decision in *Almy v. California* held that the import-export prohibitions were applicable to transactions between two states, where the same free trade spirit animated.[4] A similar free trade spirit is behind the provision in Article I, Section 9, which states categorically that "no Tax or Duty shall be laid on Articles exported from any State." This clause in fact eliminates a powerful impediment to free trade, given that the imposition of such taxes would slow down commerce and perhaps confer a competitive advantage to some states over others.[5]

Taxes of this sort provoke far less opposition than tariffs on foreign imports, such as those Hamilton defended as a protection for infant industries. Hence, in *Federalist* 11, Hamilton made clear that Congress had the power to reject, as it were, Smith's teachings on this point. It is worth noting the tariff on key imports created one of the wedge issues that led to the Civil War, as Southerners bristled against taxes on imports that gave Northerners a key advantage by increasing the price of foreign goods destined for Southern ports.

Closely related to the import-export clause is the general statement of the commerce clause, which reads: "Congress shall have the power to . . . regulate commerce with foreign nations, among the several states and with the Indian tribes."[6] The early discussions of the clause concentrated on trade with foreign nations, in which the dominant sense, gleaned as well from *Federalist* 11, was not supportive of freedom of foreign trade to cross into our national borders.[7]

To the contrary, the foreign commerce clause allowed Congress to impose tariffs and other regulations in ways that aligned with Hamilton's mercantilist sentiments. The domestic use of the clause delivers a more mixed message: domestic free trade behind a tariff wall. One problem was that states could not have the power to stop the movement of goods and services across state lines, so the question was how the federal government's power to regulate commerce either advanced or retarded trade.

In practice, both effects seemed to matter. On this front, the great case of the founding period was *Gibbons v. Ogden* (1824).[8] Aaron Ogden, an assignee of Robert Fulton, the inventor of the steamboat, had received

under New York law an exclusive license to operate steamboats in New York state waters in exchange for developing the new steam technology. Thomas Gibbons wished to operate a steamboat from Elizabethtown, New Jersey, into New York City, but New York courts honored the exclusive grant, which Gibbons then attacked in federal courts.

In the Supreme Court, Chief Justice Marshall overrode the New York state courts and held that, as a constitutional matter, regulating commerce was not limited to regulating border crossings but covered all navigation that went from the interior of one state to the interior of another.[9] This meant that Ogden could not exclude him from the state, a boost for free navigation. But the same decision held that the United States could itself regulate the entire matter by issuing coastal licenses to various vessels, which could allow it to block that coastal trade. So the clause had a dual effect, first by limiting state monopoly power but then by encouraging federal monopoly power.

This argument thus gives rise to a serious theoretical problem: Could Congress, under the guise of "encouraging and protecting domestic manufacturers," pass a law that prohibited Southern imports into another state by keeping them out of the stream of commerce? To allow that would let the federal government choke off interstate commerce from slave states, which easily could have toppled the Union. Justice Joseph Story was firmly against this, and when, in 1918, the same issue came up with the shipment of goods made with underaged child labor, a narrow 5–4 Supreme Court majority struck the effort down on the grounds that this use of federal monopoly power (although they did not use those words) upended the original division of power between the state and federal government, which had been far more acute a century before.[10]

Further complications also stemmed from *Gibbons* proper. In a concurring opinion, Justice William Johnson held that federal dominance of navigation between states could be asserted even if the federal government had passed no law at all. This gave rise to the question of what, if anything, states could do to interfere with federal power dealing with local systems of health and safety.

Shortly thereafter, *Willson v. Black-Bird Creek Marsh Co.* held that the state could construct a dam across a navigable waterway even if it interfered with navigation with interstate commerce that passed through the state.[11] But the state had a strong police power justification that its measures improved the health of the population.

The assertion of this legitimate interest controlled the outcome, but for Marshall the result would have been different if the federal government had passed legislation pursuant to the commerce clause to govern these navigable rivers. As it did not, the conflict was avoided, because the Johnson theory was not accepted. Down the road, some trade-off would have to be made when the two interests collided.

The parallel issue concerned the import-export clause. When does the federal power end and the state power begin? In *New York v. Miln*, the Court, just after the close of the Marshall era, upheld New York's inspection law for goods entering the state.[12] This offered a sensible accommodation between the federal interest in navigation and the state's internal police power.

This interplay been state and federal interests in commerce has continued into modern times, when an odd but durable synthesis has developed. Once the issue of slavery was off the table, the affirmative power of commerce steadily expanded. It first covered local transportation in competition with interstate transaction in the Shreveport Rate Cases,[13] expanding to all transportation, whether state or federal, as part of the railroad grid in *Railroad Commission of Wisconsin v. Chicago, Burlington & Quincy R. R. Co.*[14]

Finally, the clause reached all activities of any type that embraced manufacturng, agriculture, and mining as part of national commerce, permitting the federal government the power to organize monopoly pricing across multiple markets, including agriculture, motor vehicles, and labor. Thus, any serious limitations on the scope of what Congress could enact were effectively scotched.[15]

But at the same time, the anticompetitive impulses were given their strongest expressions by preventing any state from engaging in any form

of discrimination between domestic and foreign rates to create a level platform for interstate competition.[16] Both forms of regulation deviate from competitive norms. But various states blocking interstate competition more clearly disrupts trade than the price increases associated with various kinds of marketing orders. Decisions made in the founding period clearly influenced future outcomes but did not dictate them.

Takings and Procedural Due Process

The stress on the commercial society also misses another precondition for the successful emergence of a capitalist system: the protection of property from confiscation. This development started in England with the acceptance of two provisions of the Magna Carta:

> (39) No free man shall be seized or imprisoned, or stripped of his rights or possessions, or outlawed or exiled, or deprived of his standing in any other way, nor will we proceed with force against him, or send others to do so, except by the lawful judgement of his equals or by the law of the land.
>
> (40) To no one will we sell, to no one deny or delay right or justice.[17]

These two provisions worked to prevent the Crown's arbitrary seizure of property in all its forms. They functioned to eliminate any situation in which judges of the Crown would play favorites among its various subjects. No system of capitalism could possibly work without these protections. In the founding period, these principles were expressed in the Constitution by the combined operation of two provisions of the Fifth Amendment: "Nor [shall any person] be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."[18] These provisions did not receive their authoritative expositions during the founding period, but only long afterward.

Thus, the due process clause received its first reading in 1884 in *Hurtado v. California*, which held that presentment before a grand jury was not part of that basic protection, so it was possible to proceed by the less formal process of information.[19] On this view, due process, which covered chiefly the two great natural law principles of hearing the other side (*audi alteram partem*) and protection against a biased tribunal (*nemo judex in causa sua*), were of great applicability and purpose. Their unquestioned acceptance during the founding period did much to secure the future developments of the modern capitalist economy by introducing a strong rule-of-law component into the system at its formative stages, although this was compromised by the administrative reforms of the Progressive and New Deal eras, which tended to prefer the expertise of the administrative state to the decentralized activities of a competitive market.[20]

And on the takings side of the agenda, the most notable case of the founding period was *Barron v. Baltimore*, which raised the peculiar question of whether actions by the local government that denied John Barron access to a deepwater port counted as a taking for which redress was possible under federal law in a suit that the property owner had initiated in state court.[21]

Chief Justice Marshall did not address the substantive question, which gave rise to extensive litigation in subsequent years. No one obtained a federal remedy until 1897, over 30 years after the Civil War, when the adoption of a due process clause against the states in the 14th Amendment was held to trigger a federal response (in that instance, in a ratemaking case for railroads that had no factual parallel during the founding period, according to Justice John Marshall Harlan).[22] But, as a matter of constitutional interpretation, Marshall also held (relying on the passive voice in the Fifth Amendment—"nor shall private property be taken") that the protection of the takings clause applied to only the federal government and not the states.

States, for the most part, had adopted similar clauses into their own constitutions, but state takings were subject to enforcement and interpretation by state courts, which tended to work in parallel to the federal

government. More specifically, the power of the natural law tradition in the founding period was strong, including perhaps the most notable decision of Chancellor James Kent in *Gardner v. Village of Newburgh* (1816).[23] Kent, resolving a dispute that arose from an improper diversion of water rights, held that it did not matter that the New York Constitution contained no explicit protection against takings. Rather, takings without compensation could be barred on natural law grounds:

> A right to a stream of water is as sacred as a right to the soil over which it flows. It is a part of the freehold, of which no man can be disseised "but by lawful judgment of his peers, or by due process of law." This is an ancient and fundamental maxim of common right to be found in *Magna Charta,* and which the legislature has incorporated into an act declaratory of the rights of the citizens of this state.[24]

The protection of patents and copyrights in the Constitution points in the same direction. The success of a federalist system depends on the effective protection of rights by both state and national governments, which was the norm throughout this period, so that no disjunction on the protection of basic rights existed anywhere throughout the system.

The Right to Contract

The Constitution's basic structure did not offer any generalized protection of the commercial economy insofar as it involved the freedom to make binding contracts free from interference either by the state or the national government. So once again (as with the future use of the takings clause), the contracts clause that on its face was applicable only to the states—where most regulatory activities took place—had an outsized career that started in the founding period but carried through to the Civil War. The clause reads: "No State shall . . . pass any Bill of Attainder,

ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility."[25]

The question is: How far does this clause go to protect the legal structure of property rights under the general classical-liberal system? To answer that question, it is necessary to break out the two separate branches of case law articulated in the founding period.

The first applies to contracts between two (or more) *private* parties. To what extent does the contracts clause protect against state interference, and to what extent is the protection so provided consistent with classical-liberal principles? The second question, which is not quite apparent from the constitutional text, is to what extent the contracts clause protects private parties that have entered into agreements or obtained *public* charters from the state against actions that impair these obligations.

To begin, it's worth noting the odd contours of the clause, which left its scope uncertain during the founding period. As drafted, the clause binds only the states and therefore does not afford any protection against the federal government. But no accessible theory explains why that protection extends to only one level of interference—the state—when the same perils of market disruption can arise from federal interference with contracts.

Yet parallel protections against both the state and federal government are found with the bills of attainder, prohibited to the United States and the states. The same is true of ex post facto laws that are blocked to both the federal government and the states. The obvious explanation is that both levels of government are susceptible to the abuse, which was all too well established in English practice. Government disrespect for contracts is always possible at both levels of government; yet ironically, it appears that the contracts clause was designed in part to protect contracts between individuals from two or more states, which is perfectly consistent with its broad language.

Initially, the clause was intended to stop the spate of state debtor relief laws that either eliminated or reduced the amounts owing on a variety of contracts, which if allowed could destabilize the entire system of credit.[26]

But the text of the clause reads more broadly, for the clause contains no explicit subject matter limitation. Yet as noted, no obvious link connects this clause to some distinct federalism issue, such as the use of negotiable instruments across state lines.[27]

In addition, the peculiar phrasing of the guarantee, which talks about the "Obligation of Contracts," plural, raises the question of what counts as an obligation. Everyone agrees that it covers the obligation of the party to pay or perform. However, it is a closer question whether the clause imposes obligations on the creditor. This would, for example, prevent the creditor from suing to collect the debt before it is due or before some condition precedent to payment has been satisfied. Additionally, it could affect cases in which the legislature revives litigation after the statute of limitations has expired or blocks a cause of action before the time allowed under the statute.[28]

A system that tries to ensure stability and integrity should in principle bind both parties in all these situations to advance the classical-liberal ideal of the complete protection of the contractual arrangement. Indeed, the most important definition of contract at the time was that of Frenchman Robert Joseph Pothier, who wrote in broad natural law terms that a contract is "an agreement by which two parties reciprocally promise and engage or one of them singly promises to the other to give some particular thing, or to do or abstain from doing some particular act."[29]

In the civil law systems, this covered not only bargains and exchanges but also unilateral actions, including the release of a debt or other obligation, without consideration of some prior obligations. Pothier died in 1772, but after the ratification of the US Constitution, Chief Justice Marshall echoed that theme when he wrote that "a contract is an agreement in which a party undertakes to do or not to do a particular thing."[30] So it appears that the scope of the clause is broad in all these cases. The question then is how it applies in concrete cases.

On this score, the question of debtor's relief again comes to the fore, because the question is whether the contracts clause in its absolutist terms prohibits adjustment of creditors' rights through some kind of

bankruptcy protection. This was a crucial question, given that Article I, Section 8 of the Constitution stipulates that Congress can establish "uniform Laws on the subject of Bankruptcies throughout the United States," without vesting all the powers over these bankruptcies exclusively in the federal government.

In *Sturges v. Crowninshield*, the Supreme Court let the states enact their own insolvency laws—decentralized processes without a centralized court in which claims can be processed or the business reorganized—unless they required an impairment of contract or were superseded by a federal bankruptcy act.[31] The second issue was not in question here because there was no federal statute. The first issue, however, was in play. The Supreme Court, after much anxiety, applied the protection of the contracts clause to the creditor, even though the debtor was required to surrender all his property to obtain the needed protection. As a general matter, the chief justice took

> the distinction between the obligation of a contract and the remedy given by the legislature to enforce that obligation has been taken at the bar and exists in the nature of things. Without impairing the obligation of the contract, the remedy may certainly be modified as the wisdom of the nation shall direct.[32]

He then concluded that in this case, the New York law "so far as it attempts to discharge this defendant from the debt in the declaration mentioned, is contrary to the Constitution of the United States, and that the plea is no bar to the action."[33]

There is an obvious tension between the state's ability to modify a remedy and the state's ability to end the obligation altogether, which is not solved by alluding to "the nature of things." But why and how this should work was not clear, because Chief Justice Marshall had no accurate conception of the proper function of either a state insolvency law or a federal bankruptcy law. An explanation as to why the release should be allowed in whole or in part was needed.

On this point, Marshall missed the best explanation: The restriction of the remedy should be allowed whenever other adjustments in these credit arrangements can increase the deal's overall value. This could be achieved by offering the creditor a form of quid pro quo that counts as just compensation for barring their direct suit.[34]

As drafted, the contracts clause does not contain any reference to just compensation, but the correct argument should be that if the rearrangement secures the orderly reassignment of assets in ways that better all parties, it should be allowed. On the topic of state contracts, to which I shall turn shortly, *West River Bridge Co. v. Dix* did not cite *Gardner*, but it did allude to the same principle of natural law that it held was incorporated into all contracts:

> There enter conditions which arise not out of the literal terms of the contract itself; they are superinduced by the preexisting and higher authority of the laws of nature, of nations, or of the community to which the parties belong; . . . Every contract is made in subordination to them, and must yield to their control, as conditions inherent and paramount, wherever a necessity for their execution shall occur. Such a condition is the right of eminent domain.[35]

This formula reads a just compensation component into the clause. How does that arise? If these obligations are fully shielded from bankruptcy, all creditors will race to court to collect their debts, which could easily force the early collapse of the debtor's business, leaving less to go around for all creditors.

Either a state insolvency law or a federal bankruptcy should be allowed to block this result by stopping contractual enforcement so long as the assets are collected and managed collectively to produce the desired result. Thus, with this expanded perspective, the procedure should be allowed to go forward so long as the new arrangement contains protections against illegal diversions and favoritism, as all bankruptcy and insolvency laws do.

These issues were left untouched until the great case of *Ogden v. Saunders*, in which the Court held, 4–3 with both Marshall and Story in dissent, that a bankruptcy law passed *after* the creation of the obligation could block the enforcement of the obligation.[36] Justice Bushrod Washington said that the discharge had to be allowed, for otherwise the statute of frauds (which renders unenforceable certain unsigned contracts) would also count as an impairment of contract. He thought that result was indefensible since the statute was hailed as one of the great legal reforms after its initial adoption in England in 1677.[37] The same conclusion held as well for statutes of limitation, which likewise had from time immemorial cut off stale causes of action.

In dissent, Chief Justice Marshall noted the distinction between this case and *Sturges*: "In *Sturges v. Crowninshield*, the law acted on a contract which was made before its passage; in this case, the contract was entered into after the passage of the law."[38] Hence in the former case, the creditor had no notice of the law and thus could not protect himself against its application. Here the law was passed first, so the parties had ample time to adjust.

Clearly that difference means that the second statute, if it impairs the contract, does so less intrusively than the former. But for Chief Justice Marshall, the distinction did not stick. Indeed, he could not mount an effective response to claims that his view would undermine the statute of frauds, statutes of limitation, and usury laws.

But by the same token, he had a challenge that the majority could not answer. Suppose a state legislature passed a law saying that all contracts formed after this date may be modified thereafter at the legislature's will. The constitutional guarantee then becomes empty if a simple statute can override it.

How best to fix this difficulty? At this point, recall that the rigid rule in *Sturges* was untenable because, the Constitution to one side, no social justification should prevent the needed adjustments when major condition precedents failed. So even though this contract was put into effect before the statute was passed, the correct question to ask was in principle

whether, in *Sturges*, the law at the time it was passed provided some system-wide social benefit.

That same analysis works here. There is not an absolute, but only prima facie, obligation not to impair contracts. But the just compensation referred to in *Dix* carries over to private contracts as well. The same is true of the statutes of limitations that generally improve the operation of the legal system by weeding out stale claims that are difficult to prove or deny. These claims typically are not barred but will generally be pursued earlier with greater reliability and smaller expense. That improvement is shared generally so that just compensation is implicit in these cases, even as it presumptively impairs the contracts of all.

The same principle applies as well to the security of transactions increased by a recordation statute, which subordinates a valid unrecorded conveyance to a subsequent one that was recorded first. Surely, the first contract is impaired because its subordination deviates from the prior-in-time, higher-in-right rule that has been a staple of the private law since Roman times.[39] And after a fashion, a contract can be impaired by a change in the parol evidence rules that alters what kind of evidence can be introduced into case. "Big deal" is the right response, given that neither side knows who will be hurt or helped down the road. If the law seems to make a general improvement, it should prevail.

Under these examples, the just compensation principle avoids the incorrect rigidity of a hard libertarian rule that says all promises must be enforced—period—and a wholly formless situation in which any transformation of basic obligations is good so long as the legislature decrees it. Indeed, therein lies the key mistake of Justice Washington's opinion: He draws no distinction between statutes of limitations and statutes of fraud on the one side and usury laws on the other. The logic of implicit-in-kind compensation, however, cannot save usury laws that apply to discrete classes of lenders by imposing undue restraints on vital financial markets, without offering any compensation to the losers in these rigged markets. Hence, they are naked wealth transfers of the sort that any classical-liberal constitutional theory condemns.

That same argument can be made about *selective* exceptions to either statutes of frauds or statutes of limitations that skew to a favored class of individuals. At this point, there is a taking from A to B that is imposed without compensation, and that transfer looks like a form of disguised theft because there is no justification (like the prevention of force and fraud under the police power) to deal with the situation. In the founding period, political forces kept these divisive forces in check, and the basic framework held through thick and thin into the 1930s.[40] But the seeds of the future maneuvers were laid by the weak conceptual foundations when *both* sides missed the sensible legal ground that develops from the classical-liberal theory that animates the best of what is in the founders' Constitution.

The second half of any historical reading of the contracts clause deals with its application to public bodies. From the outset, no other all-purpose provision of the Constitution applied to commercial transactions generally, as any use of the takings clause lay in the future. Yet the general classical-liberal theory of limited government does not allow the state to make whatever deal it desired. That limitation of state power in *Gibbons* should have constrained the creation of any exclusive franchise to Fulton to operate steamboats in New York waters, given that the state received nothing in return from Fulton, who independently had patent protection for developing the steamship and thus should not have received that additional spur.

However, many transactions revealed serious irregularities by state legislatures. The first of these was *Fletcher v. Peck*.[41] That case arose out of the Yazoo land scandal of 1795 involving huge tracts of land that Georgia's legislature sold to land speculators at ridiculously low prices, even as native tribes claimed sovereignty over those same lands. Shortly after the sales, it was discovered that many Georgia legislators had been bribed.

Accordingly, Georgia's legislature in January 1795 passed a statute that purported to reverse the sales, given that obvious fraud. But after it reversed the grants, John Peck, a Massachusetts speculator, resold 15,000 acres of land for $3,000 to Robert Fletcher. When Peck refused to

deliver, Fletcher sued him in what was widely understood to be a collusive transaction to secure all the speculators' titles.

Amazingly, this thoroughly corrupt bargain was upheld, for both good and bad reasons. The good part of the decision was that the Court, speaking through Chief Justice Marshall, held that the contracts clause covered grants made by the government to private parties, which is strictly necessary if there were to be any federal constraint on abuses by state legislatures whose courts might or might not be responsive to the danger. But the bad part of *Fletcher* was how Marshall mangled the analysis of the transaction by showing the same rigidity toward contractual obligations that marred his later decision in *Sturges*.

Marshall claimed that no court could inquire into the legislature's motives because its obligation was absolute under some jumbled combination of natural and statutory law. That contention was just false. As noted earlier, the principles of trust law (which impose extensive good-faith duties) applied equally to public and private transactions.[42] Thus, if this transaction had been a grant by the officers or directors of a private corporation that was tainted by fraud, it could surely be set aside so long as the original recipient possessed the property received direct from the state.

The difficulties arise (as in the case of bills of exchange) where the property (like the bill) was transferred by the fraudulent recipient to a third party. If that party received in good faith—for example, without knowledge of the fraud—the original transferor (here Georgia) could have a damage action against only the original buyer. But this transaction was collusive, as both Peck and Fletcher wanted to insulate all sales from judicial scrutiny, which Marshall's opinion did.

At this point, any inquiry into motive would have exposed all the parties as acting in bad faith and set aside the transactions, which would have done much to rehabilitate the tribal claims to the land. So once again, classical-liberal principles received at most a partial vindication.

It was the positive portion of *Fletcher* that lived on in *Dartmouth College v. Woodward*, when the New Hampshire legislature gutted the initial 1769

royal charter that organized the college as a private institution.[43] The 1816 New Hampshire legislation transferred effective control of the college to the governor, done in the short run to reinstate a deposed president.

That kind of usurpation can be discovered only by looking at the records and purpose of the transaction, at which point it was an open-and-shut case of usurpation that the Marshall opinion stopped in its tracks, with only two cursory references to *Fletcher*, both to the effect that charters were contracts. The transaction struck down in *Dartmouth College* was a masterpiece of circumvention, and today the elaborate body of fraudulent conveyance and public trust doctrine has undone the worst of *Fletcher*. Its legacy lives on mostly as a constructive protection of the commercial economy and its ideals.

Patents and Copyrights

The protection of property rights during the founding period was encapsulated most clearly in Article I, Section 8, Clause 8, which provides that "the Congress shall have power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[44]

There is a great deal that is packed into the clause, whose strength comes from the interlocking impact of two complementary theories. On the one hand, much influenced by Lockean theory, a patent is treated as a form of property awarded as a recognition of the labor that an inventor or author has put into creating their work. On the other, that labor is protected because it creates an incentive for work that benefits society as a whole.

Thus, Section 1 of the Patent Act of 1790 states "that he, she, or they, hath or have invented or discovered any useful art, manufacture, engine, machine, or device, or any improvement therein not before known or used, and praying that a patent may be granted therefor."[45] I have long argued that these two overlapping justifications are complementary,[46] and an excellent detailed history of the early republican period written by

Adam Mossoff shows how these dual themes played out in not only the United States but also England and the continent.[47]

Now look more closely at their constitutional protection. The power to protect patents and copyrights is conferred on the federal government so that there is no need to negotiate multiple different patent and copyright regimes at the state level. Uniformity here is a value, partly because of the sharp reduction in the cost of organizing a registry of some sort to keep track of who owns what. There is no "natural" right to property here, that a person can protect by taking possession of some material thing, if other persons are allowed to fabricate an invention or reproduce the writing of another person. And although Congress had no obligation to protect these forms of right, the practical pressures were so strong that it enacted the Patent Act of 1790 and the Copyright Act of 1790, both of which contain many critical features that still organize these areas of law today.

First, the precatory clause, "To promote the Progress of Science and useful Arts," does not just refer to the notion of utilitarian advancement.[48] It also signals that the government could only issue patents and copyrights for these limited purposes, which thus ruled out their use to allow importers and local officials to secure monopoly control over certain markets. This provision is a huge victory for the classical-liberal perspective on this issue, which means that the federal government could not create the types of monopolies in other areas that should have been, and often were, stopped by an application of the public trust doctrine.

The last phrase, "By securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries," also helps design a sensible system. These rights are granted only for limited times and thus are held in contrast to the perpetual ownership over land or chattels, which is the hallmark of an efficient system of property rights in tangibles. The "long term" means that the owner of land or chattels does not have to puzzle as to what will be done with their house or furniture when some (arbitrary) initial period of ownership expires. It does no good to cast them out into the world and none to allow other individuals to seize them.

The perpetual time horizon allows individuals to develop and improve property without any fear that others will wrest it away from them. Thus, when the owner leases out property for some limited term, the party can make arrangements with the lessee as to what will be done with any improvement at the termination of the lease, so as to avoid that free-for-all.

Nonetheless, copyrights and patents present a fundamentally different trade-off from other forms of property. At any time after the specification of an invention or the preparation of a copyrightable work, anyone could produce their own object or writing without the cooperation of their owner, and at low cost. So if the only issue on the table is the maximum output conditional on the prior invention of the object or writing, the only protection that should be given to the inventor or author is of the particular objects that they produce. But that caveat is key. Few individuals will make any invention or writing for public use at some private cost to themselves if others are entitled to produce the same ultimate good without having to incur the costs of its creation.

Thus, without the exclusive right, many inventions would not be made or distributed to the broader public. The exclusive right usefully changes the social equation, for now there is a sufficiently long time to recoup the initial invention or writing where the creator has an exclusive right—which was the exact strategy that was used when the government gave a company the exclusive right to build a bridge: rights to charge for a period to recover costs and then a sharp or complete reduction in fees.[49] But that right is for only a limited term—14 years for a copyright, with renewal, and 14 years for a patent—because its perpetual protection will prevent others from entering that market at any future time.

Hence the law recognizes a trade-off by putting things into the public domain where they can be used by anyone against not only the original creator but also anyone else who has an exclusive right in another invention or writing that is put up for sale. So, it is wrong to think that a patent creates a monopoly when other inventors or writers face competition from other parties with substitute patented technologies. At this point, an important distinction emerges.

It is usually easy enough to figure out who has copied whose novel or poem, so that registration is freely given and any disputes over infringement or originality can take place ex post facto. But it is hard to know the exact scope of a patent. From the earliest time, a system of ex ante examination is designed to make an initial determination of patent validity. This process requires identifying "any new and useful process, machine, manufacture, or composition of matter." It also necessitates demonstrating that the advance is significant enough to merit the protection of the patent law. Further, disclosures about the modes of production must be made so that the rest of the world can gain knowledge.[50]

Care was also taken to see that matters that belonged in the public domain—natural substances and mathematical formulas—could not be taken private. Copyright had less demanding requirements for originality, but here, too, care had to be taken to make sure that matters that were already in the public domain could not be removed. The work done here was quite impressive, and much of it was shepherded through the courts by Justice and Professor Story, a formidable figure in the field until his death in 1845. The initial period thus laid a firm foundation for further work in the area. The principles articulated then still govern today.

The Pillars of a Market Economy

Each of these complicated issues and a number of others (such as the national bank and common carriers) were addressed by legislators and judges in the founding era. Each then became the basis of case law throughout the 19th century, whether in taking up commercial transactions, due process, property rights, the public trust doctrine, or the scope of federal power under the commerce clause. And each remains a crucial foundation of the law underlying the American commercial republic in our time.

In the founding period, there was a tussle between principles of economic protectionism and monopoly power on the one hand and free trade

and competition on the other. Struggles this deep and fundamental never yield black-and-white answers, but rather shift back and forth within and across different historical periods. On balance, the legislators and judges of the founding period had more sound than unsound classical-liberal instincts and thus charted a course that gave the initial edge to the desirable attributes of a sound capitalist, or free-market, system. But the character of that system has always been in question.

When Benjamin Franklin was asked what kind of Constitution the 1787 convention had created, he is said to have responded, “A republic, if you can keep it.” If we consider what kind of economic system the American republic has sought to make possible, the answer suggested by the constitutional thought and practice of the founding era might be similar: “a market system, if you can keep it.”

Notes

1. N.Y. Const. of 1777.
2. US Const. art. I, § 10.
3. *Brown v. Maryland*, 25 US 419, 439 (1827).
4. *Almy v. California*, 65 US 169 (1860).
5. US Const. art. I, § 9, cl. 5.
6. US Const. art. I, § 8, cl. 3. See Robert G. Natelson, “The Meaning of ‘Regulate Commerce’ to the Constitution’s Ratifiers,” *Federalist Society Review* 21 (2022): 308. For a contemporary exposition, see Joseph Story, *Commentaries on the Constitution of the United States*, ed. Ronald D. Rotunda and John E. Nowak (1833; Durham, NC: Carolina Academic Press, 1987). The sections on the commerce clause are §§ 510–35, which closely follow the views of Chief Justice John Marshall, to whom Joseph Story dedicated the volume. The juxtaposition of foreign, domestic, and Indian commerce suggests that all relate to activities across state lines. Their histories have wildly varied. For a broader perspective, see Jack M. Balkin, “Commerce,” *Michigan Law Review* 109 (2010): 1. For my views, see Richard A. Epstein, “The Proper Scope of the Commerce Power,” *Virginia Law Review* 73 (1987): 1387. Story offers strong support for Natelson’s position.
7. See *Federalist*, no. 11 (Alexander Hamilton). This takes the position that we should advance “Active Commerce in our own bottoms.” And further: “If we continue united, we may counteract a policy so unfriendly to our prosperity in a variety of ways. By prohibitory regulations, extending at the same time throughout the States,

we may oblige foreign countries to bid against each other, for the privileges of our markets. This assertion will not appear chimerical to those who are able to appreciate the importance." All this is a dangerous game that hurts consumers on the one side and, critically, potential exporters who need cheap imports to lower their cost of making sales overseas.

8. *Gibbons v. Ogden*, 22 US 1 (1824).

9. *Livingston v. Van Ingen*, 9 Johns. R. 507 (N.Y. 1812), written by Chancellor James Kent, a major figure of the period, the first professor at Columbia University Law School, and the author of *Commentaries on American Law*.

10. *Hammer v. Dagenhart*, 247 US 251 (1918).

11. *Willson v. Black-Bird Creek Marsh Co.*, 27 US 245 (1829).

12. *New York v. Miln*, 36 US 102 (1837).

13. *Houston East and West Texas Railway Co. v. United States*, 234 US 342 (1914).

14. See *Railroad Commission of Wisconsin v. Chicago, Burlington & Quincy R. R. Co.*, 257 US 563 (1921) (allowing the regulation of intrastate rates given that the property is used in both domestic and interstate commerce).

15. For the most dramatic case, see *Wickard v. Filburn*, 312 US 111 (1942) (allowing the price regulation of grain fed to one's own cows).

16. *H. P. Hood & Sons v. Du Mond*, 336 US 525 (1949); and *Dean Milk Co. v. City of Madison*, 340 US 349 (1951).

17. Magna Carta (1215).

18. US Const. amend. V.

19. *Hurtado v. California*, 110 US 516 (1884).

20. See Woodrow Wilson, *Congressional Government: A Study in American Politics* (Riverside Press, 1885); and James Landis, *The Administrative Process* (New Haven, CT: Yale University Press, 1938). For my overview, see Richard A. Epstein, *Design for Liberty: Private Property, Public Administration, and the Rule of Law* (Cambridge, MA: Harvard University Press, 2011).

21. *Barron v. Baltimore*, 32 US 233 (1833).

22. *Chicago, Quincy & Burlington Railroad Co. v. Chicago*, 166 US 226 (1897).

23. *Gardner v. Village of Newburgh*, 2 Johns. Ch. 162 (N.Y. 1816). *Gardner* was the "most prominent" of these cases but by no means the only one. See James W. Ely, "The Oxymoron Reconsidered: Myth and Reality in the Origins of Substantive Due Process," *Constitutional Commentary* 16, no. 315 (1999): 334.

24. *Gardner*, 2 Johns. at 164, 166.

25. US Const. art. I, § 10, cl. 1. See *Federalist*, no. 44 (James Madison) (dealing with the clause). For general accounts, see Benjamin Fletcher Wright Jr., *The Contract Clause of the Constitution* (Cambridge, MA: Harvard University Press, 1938), 3–26; and Robert L. Hale, "The Supreme Court and the Contract Clause (Pts. 1–3)," *Harvard Law Review* 57, no. 512 (1944): 621, 852. For my views, see Richard A. Epstein, "Toward a Revitalization of the Contracts Clause," *University of Chicago Law Review* 51 (1984): 703.

26. *Federalist*, no. 10 (James Madison).

27. *Swift v. Tyson*, 41 US 1 (1842) (for the defense of this result in the Supreme Court). Chancellor Kent had taken the same position as a matter of state law. See James Kent, *Commentaries on American Law* (Claitor's Pub Division, 1826), 3:81, cited in *Swift*, 41 US at 17.

28. *Sturges v. Crowninshield*, 17 US 122, 207 (1819) ("If, in a state where six years may be pleaded in bar to an action of assumpsit, a law should pass declaring that contracts already in existence, not barred by the statute, should be construed to be within it, there could be little doubt of its unconstitutionality").

29. Robert Joseph Pothier, *A Treatise on the Law of Obligations or Contracts*, trans. William David Evans (Lawbook Exchange, 1853), 1:105.

30. *Sturges*, 17 US at 197.

31. *Sturges*, 17 US at 197.

32. *Sturges*, 17 US at 200.

33. *Sturges*, 17 US at 208.

34. This is the central theme. See Epstein, "Toward a Revitalization of the Contracts Clause," 703, 740–47; and Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain*, pt. 4 (Cambridge, MA: Harvard University Press, 1985) (showing how the same dynamic works in takings cases).

35. *West River Bridge Co. v. Dix*, 47 US 507, 532–34 (1848).

36. *Ogden v. Saunders*, 25 US 213 (1827).

37. Douglas Stollery, "Statute of Frauds," *Alberta Law Review* 14 (1976): 222–23.

38. *Ogden*, 25 US at 215.

39. In *Jackson v. Lamphire*, 28 US (3 Pet.) 280, 289 (1830), the Court upheld the state's power to enact a recordation system notwithstanding the contract clause. The result in the case is correct, but the opinion itself is only a collection of platitudes.

40. For something like the end, see *Home Building and Loan Association v. Blaisdell*, 290 US 398 (1934).

41. *Fletcher v. Peck*, 10 US 87 (1810). For a concise account of the case, see Federal Judicial Center, "*Fletcher v. Peck* (1810)," https://www.fjc.gov/history/cases/cases-that-shaped-the-federal-courts/fletcher-v-peck. Story argued to uphold the validity of the contract the year before he was elevated to the bench.

42. See Natelson, "The Meaning of 'Regulate Commerce' to the Constitution's Ratifiers."

43. *Dartmouth College v. Woodward*, 17 US 518 (1819).

44. US Const. art. I, § 8, cl. 3.

45. Patent Act of 1790, 1 Stat. 109, § 1.

46. Richard A. Epstein, "The Utilitarian Foundations of Natural Law," *Harvard Journal of Law & Public Policy* 12 (1989): 713.

47. Adam Mossoff, "Rethinking the Development of Patents: An Intellectual History, 1550–1800," *Hastings Law Journal* 52 (2001): 1255.

48. Patent Act of 1790, 1 Stat. 109, § 1.

49. *Charles River Bridge v. Warren Bridge*, 36 US 420 (1837). This case ended in a 4–3 split in which the grant was not held exclusive, which is why the Warren Bridge was cheek by jowl next to the Charles River Bridge. The grant allowed the ability to charge and collect tolls for 40 years (later extended to 70 years), after which the bridge was to be turned over to the state. Note that the Charles River Bridge Company had to compensate Harvard. There is a mixture of good sense, protectionism, and public finagling in the overall deal.

50. Patent Act of 1790, § 2.