Judicially Sanctioned Orwellianism: Do We Still have the Freedom to Contract

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INTRODUCTION

One of the most fundamental precepts of a democratic state is the right of the individual to be left to his own devices, free from interference by the powers that be. In *The Second Treatise of Civil Government,* Locke captured the essence of this concept:

> We must consider what state all men are naturally in, and that is a state of perfect freedom to order their actions and dispose of their possessions and persons as they think fit, within the bounds of the law of nature, without asking leave or depending upon the will of any other man.[1]

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1. 1 MICHAEL CURTIS, THE GREAT POLITICAL THEORIES 372 (1981).

Indeed, the ideal of each man's independence from the entity to which he has delegated the authority to maintain social order — best exemplified by what jurisprudence has termed as "the right to be left alone"[2] — has long since been enshrined as a core value of democratic and republican government.

A key aspect of this right is the liberty of the individual to determine for himself the rules that will govern his interaction with his fellow man. One of the most enduring and pervasive applications of such a right is the freedom to contract. Stripped of all legalese, the freedom to contract is the inherent right of the individual to agree to any terms with another on any subject matter. The Supreme Court, in the landmark case of *People v. Pomar*,[3] committed the principle of autonomy of contract to jurisprudential immortality, when it stated: "The right to contract about one's affairs is a part of the liberty of the individual, protected by the 'due process of law' clause of the Constitution.[4] "Being inherent in each individual, the right has found sovereign expression in the non-impairment clause in the Constitution, to wit: "No law impairing the obligation of contracts shall be passed."[5] Such a guarantee in the fundamental law gives meaning to the principle of autonomy of contract: Men come to terms on any subject matter of their choosing, secure in the assurance that their covenant will not be interfered with by the otherwise omniscient State.

Be that as it may, the primary philosophical underpinnings of society and government as we know it today rest on Rosseau's postulate as enunciated in *The Social Contract,* thus:

> Men being by nature all free, equal, and independent, no one can be put out of this estate and subjected to the political power of another without his consent. The only way whereby any one divests himself of his natural liberty, and put on the bonds of civil society, is by agreeing with other men to join and unite into a community for their comfortable, safe, and peaceful living one amongst another, in a secure enjoyment of their properties and a greater security against any that are not of it.[6]

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2. Ople v. Torres, 293 SCRA 141 (1998).
3. People of the Philippines v. Pomar, 46 Phil. 440 (1924).
4. *Id.* at 452 (citing Allgeyer v. Louisiana, 165 U.S. 578, 591 (1897); New York Life Ins. Co. v. Dodge, 246 U.S. 357, 373, 374 (1918); Coppage v. Kansas, 236 U.S. 1, 10, 14 (1915); Adair v. United States, 208 U.S. 161 (1908); Lochner v. New York, 198 U.S. 45, 49 (1905); Muller v. Oregon, 208 U.S. 412, 421 (1908)).
5. PHIL. CONST. art III, § 10.
6. CURTIS, *supra* note 1, at 379.

This "trade-off" by the individual of his freedoms for a measure of government-ensured peaceful and orderly interaction with his fellow man has found legal expression in the doctrine of police power. By its very nature as one of the three inherent powers of the State,[7] it has been described as "the most essential, insistent, and illimitable of powers which enables the State to prohibit all things hurtful to the comfort, safety and welfare of society."[8] As such, the power "expands and contracts with changing needs."[9]

Hence, police power is the primary tool by which the State intervenes with what would otherwise be absolutely private covenants between individuals, in order to protect public interest. Given that the Philippines has long abandoned the *laissez faire* doctrine,[10] there is virtually no transaction today that can be considered as completely detached from public interest, and thus beyond the reach of the "ubiquitous policeman"[11] known as police power.

Although there can be no serious objection as to the wisdom, as well as the inherent constitutionality, of the expanded regulatory and protective functions of government as enunciated in a long list of decisions by the Supreme Court,[12] such active participation by the State in private transactions has inadvertently resulted in the erosion of the individual's freedom to contract. In essence, the State, through the legislature, in the exercise of police power, may now interfere with any and all contracts, by altering the remedies for their enforcement, or, if necessary, even delve into the substance of such agreements by imposing new conditions on the parties or relieving the latter of the undertakings they entered into, in complete disregard of the non-impairment clause in the constitution.[13] This is illustrated by a long list of High Court rulings, the doctrines of which have been encapsulated in the Court's declaration that "public interest is such a

7. The other two being the power of taxation and the power of eminent domain.

8. Rubi v. Provincial Board of Mindoro, 39 Phil. 660 (1918).

9. JOAQUIN G. BERNAS, S.J., THE 1987 CONSTITUTION OF THE PHILIPPINES: A COMMENTARY 95 (1996) [hereinafter BERNAS, COMMENTARY].

10. Bacani v. National Coconut Corporation, 100 Phil. 471 (1956).

11. Juarez v. Court of Appeals, 214 SCRA 475 (1992).

12. People of the Philippies v. Reyes, 67 Phil. 187 (1939); Primero v. Court of Agrarian Relations, 101 Phil. 675 (1957); Ongsiako v. Gamboa, 86 Phil. 50 (1950); Maranaw Hotel v. National Labor Relations Commission, 238 SCRA 190 (1994).

13. Rutter v. Esteban, 93 Phil. 68 (1953); Asociacion de Agricultores de Talisay-Silay, Inc. v. Talisay-Silay Milling Co., Inc., 88 SCRA 294 (1979).

broad concept that it has left the contract clause practically in shambles."[14] The eminent constitutionalist Fr. Joaquin G. Bernas, S.J. captured the moribund state of the non-impairment clause when he stated:

> With the acceptance of the superiority of police power over contract, the contract clause now has very limited usefulness. It can in fact be removed from the Constitution without substantive loss. The 1986 Constitutional Commission nevertheless decided to retain the clause for fear that removing it might fan fears and cause more economic instability.[15]

Given that the only kind of contract that an individual may now enter into is one that is subject to a "congenital infirmity"[16] (the exercise of police power), can it be said that the sacred right of autonomy of contracts, which is protected by the non-impairment clause, is still in substantial existence? Or is the doctrine established by the Supreme Court on the contract clause a form of judicial Orwellianism? Does George Orwell's "Big Brother," in the form of judicially sanctioned State interference, now obtrusively peer over the shoulder of every citizen — the latter having been deprived of the protective penumbra provided by the non-impairment clause — as he enters into private contracts?

This Note consists of four parts. Part I shall discuss the origins, rationale, evolution, essence, and application of the non-impairment clause, and establish the link between the latter and the principle of autonomy of contract. Part II shall analyze the current jurisprudential status of the non-impairment clause, particularly in relation to the expanded definition of police power. Part III shall dissect the net effect of the application of police power on the non-impairment clause and, consequently, on the freedom to contract. Part IV is an in-depth examination of the unwarranted destruction of the non-impairment clause by the Supreme Court. In conclusion, this Note will examine the jurisprudential tools that the Court may adopt in order to harmonize the inherently conflicting interests of police power and the individual's autonomy of contract.

Philippine and American jurisprudence shall be discussed and analyzed in order to prove that the Supreme Court has in effect destroyed the non-impairment clause, and consequently, the freedom to contract. Several local as well as American cases shall then be dissected, with the end goal of establishing that the current doctrine on non-impairment is in fact

14. Philippine Veterans Bank Employees Union v. Philippine Veterans Bank, 189 SCRA 14 (1990).

15. JOAQUIN G. BERNAS, S.J., THE 1987 PHILIPPINE CONSTITUTION: A REVIEWER-PRIMER 148 (2002).

16. Philippine-American Life Insurance Co. v. Auditor General, 22 SCRA 135 (1968).

unwarranted. Finally, various cases shall be applied by analogy in order to provide a framework for the harmonization of the conflicting constitutional doctrines, such that the police power of the State may exist in its present form side by side and consistent with the original concept and purpose of the non-impairment clause.

I. The Non-Impairment Clause Up Close

A. The Roots of the Cause

The non-impairment clause in the Philippines, much like the structure of modern Philippine government, is of American origin. The landmark case of *Home Building & Loan Association v. Blaisdell*[17] offers insights into the rationale behind the constitutional enshrinement of the non-impairment clause in the U.S.:

> But the reasons which led to the adoption of that clause, and of the other prohibitions of section 10 of article 1, are not left in doubt, and have frequently been described with eloquent emphasis. The widespread distress following the revolutionary period and the plight of debtors had called forth in the States an ignoble array of legislative schemes for the defeat of creditors and the invasion of contractual obligations. Legislative interferences had been so numerous and extreme that the confidence essential to prosperous trade had been undermined and the utter destruction of credit was threatened. 'The sober people of America' were convinced that some 'thorough reform' was needed which would 'inspire a general prudence and industry, and give a regular course to the business of society.' It was necessary to interpose the restraining power of a central authority in order to secure the foundations even of 'private faith.' The occasion and general purpose of the contract clause are summed up in the terse statement of Chief Justice Marshall in Ogden v. Saunders: 'The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man, touches the interest of all, and controls the conduct of every individual in those things which he supposes to be proper for his own exclusive management, had been used to such an excess by the state legislatures, as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. This mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but to sap the morals of the people, and destroy the sanctity of private faith. To guard against the continuance of the evil, was an object of deep interest with all the truly wise, as well as the virtuous, of this great community, and was one of the important benefits expected from a reform of the government.' [18]

17. Home Building & Loan Association v. Blaisdell, 290 U.S. 398 (1934).

18. *Id.* at 427-28 (citations omitted).

This concern by the federal government over the *carte blanche* attitude of many states of the Union in unilaterally modifying, or even outright abrogating, contractual relationships that had been validly entered into, is reflected in the U.S. Constitution, which provides: "No State shall pass any law impairing the obligation of contracts."[19] The U.S. Supreme Court had occasion to expound on this provision when it stated that the wisdom and the sense of justice of the framers of the U.S. Constitution are admirably reflected in that provision which prohibits any state from passing any law impairing the obligation of contracts. This restraint upon the states is a permanent guaranty in behalf of the humblest citizen as well as the largest corporation.[20]

The advent of American sovereignty in the Philippines at the beginning of the 20th century marked a radical shift in the collective outlook of the body politic. The unilateral monarchism of the Spanish era, marked by strong religious underpinnings, was replaced by the secular based, participative democracy of the U.S., which had as one of its core values the principle of equality among all men, as exemplified by the immortal statement of the American Founding Fathers: "We hold these truths to be self-evident, that all men are created equal."[21]

A fundamental aspect of such equality is the right of all members of the State to deal with each other as equals, i.e., to negotiate and bargain with one another — and with no other parties other than those involved in the pertinent transactions — free from extraneous restraints or duress. The Philippine Bill of 1902[22] absolutely prohibited the legislature of what was then referred to as the "Philippine Islands" from adopting any legislation that would impair the obligations of contracts.[23] The fact that these laws contained non-impairment clauses reflect the premium placed on the sanctity of contracts by the democratic system which was transplanted to the Philippines by the U.S. — indeed, the "guaranty" envisioned by the U.S. Supreme Court in *Iowa* was now available to one and all in the new colony. The provision on the matter in the Philippine Constitution of 1935 was a virtual replica of the American model after which it was patterned: "No law

19. U.S. CONST. art. 1, § 10.

20. Iowa Tel. Co. v. Keokuk, 226 F.2d 82 (1955).

21. THE DECLARATION OF INDEPENDENCE para. 2 (U.S. 1776).

22. Philippine Organic Act of 1902, July 1, 1902.

23. Clemons v. Nolting, 42 Phil. 702 (1922).

impairing the obligation of contracts shall be enacted."[24] The current charter provides: "No law impairing the obligation of contracts shall be passed."[25]

In essence, the non-impairment clause is simply a constitutional recognition of the freedom to contract, which consists not only of a person's right to enter into agreements, but also the protection of such agreements against undue government interference, without which the autonomy of contracts would be a mere shadow. Indeed, "the legislature, under the constitution, is not permitted to prescribe the terms of a legal contract and thereby deprive the citizens of the state from entering freely into such contracts according to their own convenience and advantage."[26]

B. Impairment Defined

What then is the legal meaning of impairment? The 1922 case of *Clemons v. Nolting*[27] established the most enduring definition of the term:

> Law which changes the terms of a legal contract between parties, either in the time or mode of performance, or imposes new conditions, or dispenses with those expressed, or authorizes for its satisfaction something different from that provided in its terms, is law which impairs the obligation of a contract and is therefore null and void.[28]

Such a definition was expounded upon further in *United States v. Diaz Conde*,[29] to wit: "Any law which enlarges, abridges, or in any manner changes the intention of the parties, necessarily impairs the contract itself." [30] Hence, when parties agree on certain terms and conditions, any attempt by the legislature to abrogate or otherwise modify the parameters of their covenant must not be countenanced. The impairment must come about as a result of legislative action, and the effect must be on the relations between the parties to the contract, and not between one of the contracting parties and a third party.[31] Furthermore, only contracts are protected by the clause,

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24. BERNAS, COMMENTARY, *supra* note 9, at 393.

25. PHIL. CONST. art. III, §10.

26. 4 ARTURO TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE CIVIL CODE OF THE PHILIPPINES 411 (1991).

27. Clemons v. Nolting, 42 Phil. 702 (1922).

28. *Id.* at 717.

29. United States v. Conde Diaz, 42 Phil. 766 (1922).

30. *Id.* at 769.

31. BERNAS, COMMENTARY, *supra* note 9, at 390.

and not franchises and privileges granted by the government to private entities.[32]

The U.S. Supreme Court, in *Home Builders,* had occasion to further expound on the true meaning of impairment: "The obligations of a contract are impaired by a law which renders them invalid, or releases or extinguishes them."[33] The Court then proceeded to cite various instances of a law that impaired the obligation of contracts. Among these were: an insolvency law passed by a state that discharged the debtor from liability was held invalid when applied to contracts which were already in existence when the law was passed;[34] laws that sought to compel landowners to either relinquish their land or pay for lasting improvements made on them by a possessor by exempting the latter from paying rents or profits to the landowner were struck down; [35] the Court likewise set aside a law that sought to grant relief to debtors — in view of the depressed economic conditions of the time — by providing that the equitable estate of the mortgagor should not be extinguished for 12 months after sale on foreclosure, and prevented any sale unless two-thirds of the property's appraised value should be bid for, in view of the fact that the extension of the period for redemption was unconditional, as well as the fact that there was no provision to secure to the mortgagee the rental value of the property during the extended period.[36]

The Supreme Court adopted the definition established by its American counterpart when it held that for as long as the "integrity of the contract"[37] is preserved, there is no impairment. Thus, it may be said that for as long as the parties are required to perform the *same obligation* which they first entered into under the contract, under essentially the same circumstances, with no substantive conditions added to or removed from the obligation, and provided rights which have vested prior to the law's effectivity are not prejudiced,[38] regardless of the effect of the law on the contract, there is no impairment.

It is however crucial to differentiate between impairment of the *substance* of a contract and the remedies for its enforcement. The need for this is emphasized by the jurisprudential line drawn by the Philippine as well as the American Supreme Court between the substantive and remedial aspects of a

32. Manila Electric Company v. Province of Laguna, 306 SCRA 750 (1999).

33. Home Building & Loan Association v. Blaisdell, 290 U.S. 398 (1934).

34. Sturges v. Crowninshield, 4 U.S. (4 Wheat.) 122 (1819).

35. Green v. Biddle, 21 U.S. 1 (1823).

36. Bronson v. Kinzie, 42 U.S. 311 (1843).

37. Churchill v. Rafferty, 32 Phil. 580 (1915).

38. Feati University v. Court of Industrial Relations, 18 SCRA 191 (1966).

contract. *Home Builders* restated the "distinction between obligation and remedy,"[39] to wit:

> 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.[40]

This principle was reaffirmed and qualified in *Von Hoffman v. City of Quiney*,[41] thus: "It is competent for the States to change the form of the remedy or to modify it otherwise, as they may see fit, provided no substantial right secured by the contract is thereby impaired."[42]

The difference between the substantive and procedural aspects of a law or, for that matter, a contract, is a basic precept in Remedial Law, thus: substantive law is one that creates or modifies rights, and procedural law provides for the means to enforce such rights. *Manila Trading & Supply Co. v. Reyes*[43] offers a clear illustration of the application of these concepts and the bifurcation between the two aspects of a contract. Here, the dispute centered on Act. No. 4122, otherwise known as the Installment Sales Law. The law in question gave the creditor the option of foreclosing on the mortgage constituted to secure the debt in the event of the mortgagor's default. However, the law prohibited the mortgagee, should the latter exercise the option given him, from proceeding against the mortgagor for any deficiency amount subsequent to the foreclosure. The law declared null and void any agreement to the contrary.

In said case, after the enactment of the law, Reyes executed a chattel mortgage over a vehicle in favor of Manila Trading, as security for the payment of his indebtedness to the latter. Having defaulted in his installment payments, Manila Trading foreclosed on the chattel mortgage. Nonetheless, the amount raised from the sale of the vehicle at public auction was insufficient to cover Reyes' indebtedness. Manila Trading then sought to collect the amount by way of a collection suit. Reyes interposed the defense that Act No. 4122 prevented Manila Trading from collecting any post-foreclosure indebtedness. The trial court upheld Reyes' contention and absolved him from the obligation to make any further payments. Manila Trading then assailed the constitutionality of the Installment Sales Law

39. Home Building & Loan Association v. Blaisdell, 290 US 398 (1934).

40. *Id.*

41. Von Hoffman v. City of Quincy, 71 U.S. 535 (1866).

42. *Id.*

43. Manila Trading & Supply Co. v. Reyes, 62 Phil. 461 (1935).

before the Supreme Court, alleging, among others, that it "unduly restrains the liberty of a person to contract with respect to his property rights."[44]

The Supreme Court first discussed the public policy behind the enactment of the law:

> Act No. 4122 aims to correct a social and economic evil, the inordinate love for luxury of those who, without sufficient means, purchase personal effects, and the ruinous practice of some commercial houses of purchasing back the goods sold for a nominal price besides keeping a part of the price already paid and collecting the balance, with stipulated interest, costs, and attorney's fees. For instance, a company sells a truck for P6, 500. The purchaser makes a down payment of P11,500, the balance to be paid in twenty-four equal installments of P250 each. Pursuant to the practice before the enactment of Act No. 4122, if the purchaser falls to pay the first two installments, the company takes possession of the truck and has it sold at public auction at which sale it purchases the truck for a nominal price, at most P500, without prejudice to its right to collect the balance of P5,500, plus interest, costs, and attorney's fees. As a consequence, the vendor does not only recover the goods sold, used hardly two months perhaps with only slight wear and tear, but also collects the entire stipulated purchase price, probably swelled up fifty per cent including interest, costs, and attorney's fees. This practice is worse than usurious in many instances. And although, of course, the purchaser must suffer the consequences of his imprudence and lack of foresight, the chastisement must not be to the extent of ruining him completely and, on the other hand, enriching the vendor in a manner which shocks the conscience. *The object of the law is highly commendable. As to whether or not the means employed to do away with the evil above-mentioned are arbitrary will be presently set out.* Undoubtedly the principal object of the above amendment was to remedy the abuses committed in connection with the foreclosure of chattel mortgages. This amendment prevents mortgagees from seizing the mortgaged property, buying it at foreclosure sale for a low price and then bringing suit against the mortgagor for a deficiency judgment. The almost invariable result of this procedure was that the mortgagor found himself minus the property and still owing practically the full amount of his original indebtedness. Under this amendment the vendor of personal property, the purchase price of which is payable in installments, has the right to cancel the sale or foreclose the mortgage if one has been given on the property. Whichever right the vendor elects he need not return to the purchaser the amount of the installments already paid, if there be an agreement to that effect.' Furthermore, if the vendor avails himself of the right to foreclose the mortgage this amendment prohibits him from bringing an action against the purchaser for the unpaid balance. In other words, under this amendment, in all proceedings for the foreclosure of chattel mortgages, executed on chattels which have been sold on the

44. *Id.* at 465.

> installment plan, the mortgagee is limited to the property included in the mortgage. [45]

The Court then laid down the principle, found in American jurisprudence, that:

> Parties have no vested right in particular remedies or modes of procedure, and the legislature may change existing remedies or modes of procedure without impairing the obligation of contracts, provided an efficacious remedy remains for enforcement. But changes in the remedies available for the enforcement of a mortgage may not, even when public policy is invoked as an excuse, be pressed so far as to cut down the security of a mortgage without moderation or reason or in a spirit of oppression.[46]

With these postulates as a backdrop, the Court held that Manila Trading, as mortgagee, had three options in light of the modifications in remedy made by Act No. 4122, namely:

1. Seeking fulfillment of the mortgagor's obligations under the mortgage contract;
2. Should the mortgagor default on two or more installments, the mortgagee may cancel the contract; and
3. Should there be default on two or more installments, the mortgagee may foreclose on the mortgage.

The last two options, according to the Court, were based on the Installment Sale Law. Thus, the latter did "no more than qualify the remedy."[47] In upholding the constitutionality of the Installment Sale Law, the Court laid down the principle that "the Legislature may change judicial methods and remedies for the enforcement of contracts, as it has done by the enactment of Act No. 4122, without unduly interfering with the obligation of the contract."[48]

The cornerstone for the Court's decision was the fact that Manila Trading had three options under Act No. 4122 in order to be able enforce its rights under the contract, all three of which were equally viable, efficacious, and would arrive at the same end result, namely the mortgagee's coming into possession of either money or property to answer for what was due him under the contract. In other words, the law still required the mortgagor to fulfill the same obligation he entered into under the contract (to pay a certain amount on a regular basis), and allowed the mortgagee to come into

45. *Id.* at 467-68 (emphasis supplied).

46. *Id.*

47. *Id.* at 471.

48. *Id.*

possession of the amounts due him under the contract, and the manner of enforcement did not lessen the compulsive force or essential nature of the obligation, or make it substantially more difficult for the mortgagee to secure what was his under the contract. Thus, the fact that one of the remedies, namely that of foreclosure, was qualified by the limitation that no further collection could be made subsequent to it was immaterial, since the remedy was not reduced to what the U.S. Supreme Court termed as a mere "shadow,"[49] and thus useless.

So goes the rule. Parties to the contract are entitled to the preservation of the integrity of the contract, in terms of its conditions, obligations to be performed under it, and its essential enforceability. However, the parties have no vested right to any mode of enforcement of their contract, and the legislature may validly change or modify any of the *means* by which the contract is enforced, provided the remedies are not made so inefficacious that the means for enforcement — and thus the contract itself — are reduced to impotence. This is especially true in light of the U.S. Supreme Court's statement that "nothing can be more material to the obligation than the means of enforcement. The ideas of validity and remedy are inseparable, and both are parts of the obligation, which is guaranteed by the Constitution against invasion."[50] However, as will be discussed further on in this Note, the line between the remedial and substantive aspects of a contract would become finer as the doctrine on the subject evolved, until the distinction was eventually delegated to the dustbin of jurisprudential history.

II. Police Power: Roots, Essence and Evolution

The non-impairment clause, however, did not come into force in a vacuum. As this Part will show, the concept of police power developed contemporaneously with the non-impairment clause, and took shape and evolved on a parallel basis with the latter.

A. The Roots and Evolution of Police Power

The concept of police power existed as early as the time of Hobbes, as seen in the latter's discourse in *Leviathan*: "And as the power, so also the honor of the sovereign, ought to be greater, than that of any, or all the subjects…to the care of the sovereign belongeth the making of good law…a good law is that, which is *needful,* for the *good of the people*."[51] These philosophical underpinnings can be seen in the jurisprudential concept of police power,

49. Worthen v. Kavanaugh, 295 U.S. 56, 62 (1935).

50. Von Hoffman v. City of Quincy, 71 U.S. 535 (1866).

51. Curtis, *supra* note 1, at 345, 348.

which has been defined as "the power...to prevent all that is hurtful to the comfort, safety, and welfare of society,"[52] and is based on the modern day legal principle of "*salus populi est suprema lex* (the welfare of the people is the supreme law),"[53] as well as the "imperative necessity of preserving the State itself."[54]

Police power, along with the power to tax and the power of eminent domain, is inherent in modern government.[55] Its jurisprudential advent in the Philippines can be traced as far back as the 1904 case of *United States v. Arceo*,[56] which dealt with the inviolability of domicile. This was followed by various decisions that examined police power and its implications for governmental regulation of private activities. Among such decisions were: police power as the foundation of criminal law,[57] police power as the basis for the power of the executive to deport aliens,[58] police power and the quarantine and slaughter of animals bearing communicable diseases,[59] the regulation of the use of public utilities,[60] the abatement of nuisances,[61] and other activities.

However, it was precisely the wide applicability of police power that gave rise to the vagueness in its scope, definition, and effects. Although there was never any serious disagreement as to the fact that public safety and welfare were the impetus behind police power, attempts to canalize such an abstract ideal fell short of the sharp-edged clarity essential to judicial concepts. Such an ambiguity is best illustrated by the nebulous statement of the Court in *Fabie v. City of Manila*,[62] to wit:

> *Much difficulty has been experienced by the courts and text writers in the attempt to define the police power of the state, and to set forth its precise limitations*. In fact it has been said to be, from its very nature incapable of any exact definition or limitation. Mr. Thompson in his exhaustive treatise on Corporations

52. Rubi v. Provincial Board, 39 Phil. 660 (1918).

53. JOSE N. NOLLEDO, THE NEW CONSTITUTION OF THE PHILIPPINES ANNOTATED 54 (1997).

54. *Id.*

55. BERNAS, COMMENTARY, *supra* note 9, at 95.

56. United States v. Arceo, 3 Phil. 381 (1904).

57. Collins v. Wolfe, 4 Phil. 534 (1905).

58. Forbes v. Chuoco Tiaco and Crossfield, 16 Phil. 534 (1910).

59. Punzalan v. Ferriols, 19 Phil. 214 (1911).

60. City of Manila v. Manila Electric Railroad & Light Co., 23 Phil. 547 (1912).

61. Iloilo Ice & Cold Storage Company v. The Municipal Council of Iloilo, 24 Phil. 471 (1913).

62. Fabie v. City of Manila, 21 Phil. 486 (1912).

> summarizes as follows the conclusions of the leading adjudicated cases and authorities touching this subject. He says:
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> Its business is to regulate and protect the security of social order, the life and health of the citizen, the comfort of an existence in thickly populated communities, the enjoyment of private and social life, and the beneficial use of property…*However courts may differ as to the extent and boundaries of this power, and however difficult it may be of precise definition,* there is a general agreement that it extends to the protection of the lives, health and property of the citizens, and to the preservation of good order and the public morals. In the absence of any constitutional prohibition, a legislature may lawfully prevent all things hurtful to the comfort, safety, and welfare of society though the prohibition invades, the right of liberty or property of an individual.[63]

This jurisprudential void, however, was filled by the landmark case of *Churchill v. Rafferty*.[64] Here, by way of a comprehensive and judicious survey of American decisions on the matter, the Court clearly and unequivocally outlined the concept, nature, extent, and effects of police power as one of the three inherent governmental powers, thus:

> There can be no doubt that *the exercise of the police power of the Philippine Government belongs to the Legislature and that this power is limited only by the Acts of Congress and those fundamental principles which lie at the foundation of all republican forms of government.* An Act of the Legislature which is obviously and undoubtedly foreign to any of the purposes of the police power and interferes with the ordinary enjoyment of property would, without doubt, be held to be invalid. But where the Act is *reasonably within a proper consideration of and care for the public health, safety, or comfort, it should not be disturbed by the courts…While the state may interfere wherever the public interests demand it, and in this particular a large discretion is necessarily vested in the legislature to determine, not only what the interests of the public require, but what measures are necessary for the protection of such interests; yet, its determination in these matters is not final or conclusive, but is subject to the supervision of the courts.*
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> The numerous attempts which have been made to limit by definition the scope of the police power are only interesting as illustrating its *rapid extension within comparatively recent years to points heretofore deemed entirely within the field of private liberty and property rights*. Blackstone's definition of the police power was as follows: 'The due regulation and domestic order of the kingdom, whereby the individuals of the state, like members of a well governed family, are bound to conform their general behavior to the rules of propriety, good neighborhood, and good manners, to be decent, industrious, and inoffensive in their respective stations.'

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63. *Id.* at 489 (citing 1 THOMPSON ON CORPORATIONS § 421 (2d ed.)) (emphasis supplied).
64. Churchill v. Rafferty, 32 Phil. 580 (1915).

Chanceller Kent considered the police power the authority of the state 'to regulate unwholesome trades, slaughter houses, operations offensive to the senses.' Chief Justice Shaw of Massachusetts defined it as follows: 'The power vested in the legislature by the constitution to make, ordain, and establish all manner of wholesome and reasonable laws, statutes, and ordinances, either with penalties or without, not repugnant to the constitution, as they shall judge to be for the good and welfare of the commonwealth, and of the subjects of the same.'

In Champer vs. Greencastle, it was said: 'The police power of the State, so far, has not received a full and complete definition. It may be said, however, to be the right of the State, or state functionary, to prescribe regulations for the good order, peace, health, protection, comfort, convenience and morals of the community, which do not violate any of the provisions of the organic law.'

In Com. vs. Plymouth Coal Co., it was said: 'The police power of the state is difficult of definition, but it has been held by the courts to be the right to prescribe regulations for the good order, peace, health, protection, comfort, convenience and morals of the community, which does not encroach on a like power vested in congress or state legislatures by the federal constitution, or does not violate the provisions of the organic law; and it has been expressly held that the fourteenth amendment to the federal constitution was not designed to interfere with the exercise of that power by the state.'

In People vs. Brazee, it was said: 'It [the police power] has for its object the improvement of social and economic conditions affecting the community at large and collectively with a view to bring about 'the greatest good of the greatest number.' Courts have consistently and wisely declined to set any fixed limitations upon subjects calling for the exercise of this power. *It is elastic and is exercised from time to time as varying social conditions demand correction*.'

In 9 Cyc., 963, it is said: 'Police power is the name given to that inherent sovereignty which it is the *right and duty of the government* or its agents to exercise whenever public policy, in a broad sense, demands, for the *benefit of society at large, regulations to guard its morals, safety, health, order* or to insure in any respect such economic conditions as an advancing civilization of a high complex character requires.'

Finally, the Supreme Court of the United States has said in Noble State Bank vs. Haskell: 'It may be said in a general way that the police power extends to all the *great public needs*. It may be put forth in aid of what is sanctioned by usage, or held by the prevailing morality or strong and preponderant opinion to be greatly and immediately necessary to the public welfare.'

The basic idea of civil polity in the United States is that government should interfere with individual effort only to the extent necessary to preserve a healthy social and economic condition of the country. State interference with the use of private property may be exercised in three ways. First,

through the power of taxation, second, through the power of eminent domain, and third, through the police power. By the first method it is assumed that the individual receives the equivalent of the tax in the form of protection and benefit he receives from the government as such. By the second method he receives the market value of the property taken from him. But under the third method the benefits he derives are only such as may arise from the maintenance of a healthy economic standard of society and is often referred to as *damnum absque injuria.*

'There was a time when state interference with the use of private property under the guise of the police power was practically confined to the suppression of common nuisances. At the present day, however, industry is organized along lines which make it possible for large combinations of capital to profit at the expense of the socio-economic progress of the nation by controlling prices and dictating to industrial workers wages and conditions of labor. Not only this but the universal use of mechanical contrivances by producers and common carriers has enormously. increased the toll of human life and limb in the production and distribution of consumption goods. *To the extent that these businesses affect not only the public health, safety, and morals, but also the general social and economic life of the nation, it has been and will continue to be necessary for the state to interfere by regulation.* By so doing, it is true that the enjoyment of private property is interfered with in no small degree and in ways that would have been considered entirely unnecessary in years gone by. The regulation of rates charged by common carriers, for instance, or the limitation of hours of work in industrial establishments have only a very indirect bearing upon the public health, safety, and morals, but do bear directly upon social and economic conditions. To permit each individual unit of society to feel that his industry will bring a fair return; to see that his work shall be done under conditions that will not either immediately or eventually ruin his health; to prevent the artificial inflation of prices of the things which are necessary for his physical well being are matters which the individual is -no longer capable of attending to himself. It is within the province of the police power to render assistance to the people to the extent that may be necessary to safeguard these rights.

Offensive noises and smells have been for a long time considered susceptible of suppression in thickly populated districts. Such statutes…are usually upheld on the theory of safeguarding the public health. But we apprehend that in point of fact they have little bearing upon the health of the normal person, but a great deal to do with his physical comfort and convenience and not a little to do with his peace of mind. Without entering into the realm of psychology, we think it quite demonstrable that sight is as valuable to a human being as any of his other senses, and that the proper ministration to this sense conduces as much to his contentment as the care bestowed upon the senses of hearing or smell, and probably as much as both together. Objects may be offensive to the eye as well as to the nose or ear. Man's esthetic feelings are constantly being appealed to through his sense of sight…Why, then, should the Government not

> interpose to protect from annoyance this most valuable of man's senses as readily as to protect him from offensive noises and smells?
>
> It has been urged against ministering to the sense of sight that tastes are so diversified that there is no safe standard of legislation in this direction. We answer in the language of the Supreme Court in Noble State Bank vs. Haskell, and which has already been adopted by several state courts, that. 'the prevailing morality or strong and preponderating opinion' demands such legislation. *If the police power may be exercised to encourage a healthy social and economic condition in the country, and if the comfort and convenience of the people are included within those subjects, everything which encroaches upon such territory is amenable to the police power. A source of annoyance and irritation to the public does not minister to the comfort and convenience of the public.*
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> xxx xxx xxx
>
> *The police power cannot interfere with private property rights for purely esthetic purposes.* The courts, taking this view, rest their decisions upon the proposition that the esthetic sense is disassociated entirely from any relation to the public health, morals, comfort, or general welfare and is, therefore, beyond the police power of the state. But we are of the opinion, as above indicated, that *unsightly advertisements or signs, signboards, or billboards which are offensive to the sight, are not disassociated from the general welfare of the public.*[65]

B. Police Power as it Stands Today

From this lengthy discourse by the High Court, the following precepts may be gathered: First, police power is essentially legislative. As such, it is subject only to the same limits as those that are imposed on the Legislature, as well as the Constitution. Second, although the object and manner of exercise of police power is a legislative task, it is subject to judicial review. Third, police power has as its aim the protection of public welfare, health, morals, and the improvement of society. Thus, even private matters and transactions may be the valid subject of its exercise, provided these somehow have a bearing on public interest. Finally and as a corollary to the third principle, although the essence of police power is undeniably public welfare, police power is also a flexible, changing concept. Hence, it is impossible to limit or predict with absolute certainty the matters that may or may not be subject to its exercise.

Subsequent Supreme Court decisions involving police power have adopted the comprehensive definition established by *Churchill,* and are reflective of the aforementioned basic postulates. Among the more notable cases on the matter are those that dealt with the mandatory leave granted to pregnant working women and the interest of the State in protecting the

65. *Id.* at 602-11 (citations omitted) (emphasis supplied).

health of such class of persons,[66] the limitations on the physical mobility of the so-called "non-Christian tribes" during the American colonial period, in order to uplift their socio-economic status and educate them in the ways of modern living, and thus prevent their becoming burdens to society or easy prey for unscrupulous persons,[67] segregation of lepers to prevent the spread of their disease,[68] the regulation of the sale of intoxicating liquor,[69] the limitations on the rental of motel rooms in order to curb illicit sex and thus preserve public morals,[70] and the mandatory requirements for car owners to install appropriate early warning devices in their vehicles to minimize road accidents.[71]

Given the almost unlimited variety of cases to which the Supreme Court has applied the concept of police power, it may be said that there is now no longer any matter which is beyond its reach. This is especially true in light of the jurisprudential recognition that the government is no longer limited to the fundamental matters pertaining to State existence and societal bonds which have been traditionally associated with it, otherwise known as its constituent functions, and with all other affairs, or the ministrant functions of society, best left to individuals and private groups, with government intervention in such only optional.[72] The rule today is, in a complex society, most, if not all, affairs must necessarily include government participation in one form or the other.

Indeed, the universal applicability of police power was best captured by Chief Justice Claudio Teehankee in his concurring opinion in *Bataan Shipyard and Engineering Co., Inc. v. PCGG*,[73] to wit: "Its scope expands and contracts with changing needs." There can be no valid objection to the exercise of police power, no individual right that may stand in its way, for as long as two requisites are met, namely:

1. Public interest demands the exercise of police power; and

66. People of the Philippines v. Pomar, 46 Phil. 440 (1924).

67. Rubi v. Provincial Board of Mindoro, 39 Phil. 660 (1919).

68. Lorenzo v. Director of Health. 50 Phil. 595 (1927).

69. Luta v. Zambaonga, 50 Phil. 748 (1927).

70. Ermita-Malate Hotel and Motel Operators Association, Inc. v. Mayor of Manila, 20 SCRA 849 (1967).

71. Agustin v. Edu, 98 SCRA 195 (1979).

72. Bacani v. National Coconut Corporation, 100 Phil. 468 (1956).

73. Bataan Shipyard and Engineering Co. v. Presidential Commission on Good Government, 150 SCRA 181 (1987).

2. The means employed must have a substantial and reasonable relation to the end sought to be achieved, and that such means must not be unduly oppressive upon individuals.[74]

III. The Interplay of Police Power and the Non-Impairment Clause

A. The Non-Impairment Clause Prior to the Evolution of Police Power

In this jurisdiction, one of the first cases that dealt with the non-impairment clause is *Gaspar v. Molina*.[75] In said case, Gaspar entered into a contract of sale with Molina for the sale of some hats to the latter. Gaspar then sought to enforce payment by way of a court action. The trial court found in favor of Gaspar. However, there was no stipulation in the contract pertaining to the currency to be used for payment. Although the Court found that Molina should pay Gaspar in Mexican pesos, since the United States had not yet fully consolidated its sovereignty over the Philippines at the time the contract of sale was entered into, it nonetheless converted the amount in Mexican pesos that Molina was bound to pay Gaspar into Philippine currency, in compliance with Act No. 1045, which was the applicable law on the matter and enacted during the pendency of the action. The applicable provisions of the law were:

> SEC. 3. Whenever any contract, debt, or obligation, payable by the terms thereof in local currency, is sought to be enforced in any court and the right of the plaintiff is established, it *shall be the duty of the court to render judgment for the plaintiff to recover as damages the lawful sum due to him, in Philippine pesos, instead of in the currency mentioned in the contract, debt, or obligation.* For the purpose of determining the amount of such judgment the court shall receive evidence as to the real and just value in Philippine currency of the currency named in the contract, debt, or obligation, including evidence of the local market value of such currency, its value in neighboring countries as currency, its value in the great markets of the world, its bullion value, and any other facts necessary to determine its true value. The local market value, whether affected by the prohibition of the importation of such currency or by other causes, shall not be conclusive evidence of the amount of the judgment to be rendered in such eases. Payment of a judgment thus rendered shall extinguish all liability on the contract, debt, or obligation.
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> xxx xxx xxx

74. *Id.* at 248.

75. Gaspar v. Molina, 5 Phil. 197 (1905).

> SEC. 5. The two last preceding sections shall *apply to all contracts, debts, or obligations made before the passage of this act,* as well as to those made subsequent thereto.[76]

Molina then assailed the constitutionality of the law, asserting that it impaired the obligation of his contract with Gaspar, since it was entered into prior to the law's passage, and did not specify the currency to be used in satisfying the obligation under it. In brushing aside Molina's contention and upholding the law's constitutionality, the Court held that the contract between he and Gaspar was not impaired by the new law, as the obligation to pay a determinate amount, and no more than that, remained. The conversion from Mexican to Philippine pesos did not impair the rights of either the creditor or the debtor. The same amount, albeit in different currencies, would be paid. Thus, the debtor would still shell out the same amount, and the creditor would receive what he was originally promised. The Court held that only the remedy, and not the substance, of the contract, was affected. Hence, there could be no impairment.

The Court's categorization of the conversion from Mexican to Philippine pesos as a mere remedial and not substantive issue is vulnerable to serious questions within the contemporary economic context, in view of the erratic fluctuations of foreign exchange rates, the concept of the cost of money, and similar issues. The value of the *Gaspar* lies in the fact that it established the treatment which the Court would accord to non-impairment cases for many years to come: the remedy could be modified, changed, or even completely set aside by law, and for as long as the parties could still enforce the contract which they entered into, there could be no impairment. But the moment any of the conditions of the contract, or the nature of the obligation, or the intention of the parties, are changed, then the non-impairment clause would come into play and prevent legislative interference with the substance of the contract.

Conde Diaz[77] offers the clearest illustration of the treatment by the Court of the non-impairment clause prior to the advent of the expanded definition of police power. In said case, Vicente Diaz Conde and Apolinaria De Conde

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76. An Act for the Purpose of Providing Revenue and Maintaining the Parity of the Philippine Currency in Accordance with the Provisions of Sections One and Six of the Act of Congress Approved March Second, Nineteen Hundred and Three, By Providing for the Purchase of Mexican Dollars as Bullion, By Imposing a Tax Upon Written Contracts Payable in Certain Kinds of Currencies and By Requiring the Payment of a License Tax by All Persons, Firms, or Corporations Conducting their Current Business, Either Wholly or In Part In Said Currencies, And for Other Purposes, Act No. 1045, §§ 3 and 5 (1904).

77. United States v. Conde Diaz, 42 Phil. 766 (1922).

were convicted for violation of the Usury Law. On appeal to the Court, the two alleged that they could not have violated the law in question, as the contract which gave rise to the criminal complaint and conviction was entered into prior to the effectivity of the Usury Law. The trial court had rejected this contention on the grounds that although the law may not have yet been effective when the contract was executed, the defendants continued to collect usurious interest after the law came into force, thus bringing their actions within its ambit.

The Court acquitted both defendant-appellants, on the ground that applying the Usury Law to the defendants would constitute a constitutionally-proscribed ex post facto law, as it would criminalize actions that, when committed, were legal.

What is of real interest, however, is the Court's statement on the effects of the Usury Law on the contract in question:

> A *law imposing* a new penalty, or a new *liability or disability,* or giving a new right of action, *must not be construed as having a retroactive effect. It is an elementary rule of contract that the laws in force at the time the contract was made must govern its interpretation and application.* Laws must be construed prospectively and not retrospectively. *If a contract is legal at its inception, it cannot be rendered illegal by any subsequent legislation.* If that were permitted then the obligations of a contract might be impaired, which is prohibited by the organic law of the Philippine Islands.[78]

This statement of the Court, particularly when read in relation to *Gaspar* and the substantive-remedial bifurcation established by the latter, highlights the absolute rule which guided decisions on the matter for a considerable amount of time thereafter. No law that is enacted or takes effect subsequent to an existing contract may void or otherwise amend in any manner the *substantive* parts of the latter. This principle would reappear on a consistent basis in the non-impairment cases that would follow.[79]

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78. *Id.* at 769 (emphasis supplied).

79. Balboa v. Farrales, 51 Phil. 498 (1928); Manila Trading Co. v. Reyes, 62 Phil. 461 (1935); Manantan v. Municipality of Luna, 82 Phil. 844 (1949); Rutter v. Esteban, 93 Phil. 68 (1953); Government of the Philippine Islands v. Visayan Surety and Insurance Corp., 66 Phil. 326 (1938); Victoriano v. Elizalde Rope Worker's Union, 59 SCRA 54 (1974); Philippine National Bank v. Ereneta, 106 Phil. 133 (1959); Co v. Philippine National Bank, 114 SCRA 842 (1982),

B. Rutter v. Esteban *and the Beginning of the End for the Non-Impairment Clause*

However, the sanctity granted by the Court to the non-impairment clause was neither perpetual nor absolute. Like two trains running on parallel lines, police power and the non-impairment clause passed their respective jurisprudential stops as their doctrines evolved, until, like the operator who inadvertently switches the tracks, the Court placed the two constitutional precepts on their inevitable collision course, with the non-impairment clause derailed on impact with the onrushing mammoth called police power.

The first case that reflected the less rigid view of the Court on the non-impairment clause is *Rutter v. Esteban*.[80] The controversy arose from the sale on installment of two parcels of land by Rutter to Esteban. In order to secure payment of the obligation, a mortgage was constituted over the parcels of land. Esteban eventually defaulted in his payment of the sums due, prompting Rutter to institute collection proceedings in court. Esteban alleged the debt moratorium provisions of Republic Act No. 342 by way of defense, asserting that, as one who suffered property damage during the Second World War, he fell within the coverage of the law. The latter imposed an eight year moratorium on the collection of debts arising from contracts entered into prior to 8 December 1941, the date of the Japanese attack on the Philippines. The period was to run from the time of settlement of the debtor's war damage claim by the Philippine War Damage Commission. The policy behind this law was to give debtors a reasonable period to rehabilitate themselves financially before settling their obligations. The trial court ruled that Esteban's obligation to Rutter was not yet due and demandable, by virtue of R.A. No. 342.

Rutter then assailed the law's constitutionality in his appeal to the Supreme Court, alleging that it violated the non-impairment clause. The Court conceded that although it was possible that R.A. No. 342 did in fact impair the obligation of contract between Rutter and Esteban, nonetheless, "this argument, however, does not now hold water."[81] This due to the fact "that (the impairment of the contract) is however justified as a valid exercise by the State of its police power."[82] In arriving at this doctrine, the Supreme Court relied heavily on the U.S. case of *Home Building and Loan Association v. Blaisdell*,[83] and quoted Chief Justice Charles Evan Hughes' *ponencia*:

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80. Rutter v. Esteban, 93 Phil. 68 (1953).

81. *Id.* at 72.

82. *Id.*

83. Home Building & Loan Association v. Blaisdell, 290 U.S. 398 (1934).

> Not only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but *the State also continues to possess authority to safeguard the vital interest of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.* Not only are existing laws read into contracts in order to fix obligations as between the parties, but *the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while, a government which retains adequate authority to secure the peace and good order of society.* This principle of harmonizing the constitutional prohibition with the necessary residuum of state power has had progressive recognition in the decisions of this court…*The economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts.* Similarly, *where the protective power of the State is exercised in a manner otherwise appropriate in the regulation of a business it is no objection that the performance of existing contracts may be frustrated* by the prohibition of injurious practices. *The question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end.* [84]

Be that as it may, the Court did not proceed to *ipso facto* nullify the contract between Rutter and Esteban. Instead, it proceeded down the path previously cleared by *Home Building,* and sought to balance the common weal espoused by police power with the inherent right to contract protected by the non-impairment clause. *Home Building* established the imperative necessity of such a prudent weighing of both principles when it stated:

> Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. *The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them. But it does not follow that conditions may not arise in which a temporary restraint of enforcement may be consistent with the spirit and purpose of the constitutional provision and thus be found to be within the range of the reserved power of the State to protect the vital interests of the community.* It cannot be maintained that the constitutional prohibition should be so construed as to prevent limited and temporary interpositions with respect to the enforcement of contracts if made necessary by a great public calamity such as fire, flood, or earthquake…The reservation of state power appropriate to such extraordinary conditions may be deemed to be as much a part of all contracts, as is the reservation of state power to protect the public interest in the other situation to which we have referred. And if state power exists to give temporary relief from the

84. *Rutter*, 93 Phil. at 73-74 (emphasis supplied).

> enforcement of contracts in the presence of disasters due to physical causes such as fire, flood or earthquake, that power cannot be said to be nonexistent when the urgent public need demanding such relief is produced by other and economic causes.[85]

Applying the principle of harmonization laid down in *Home Builders* to the case at bar, the Court acknowledged the fact that such a principle had its limitations, and was not a magic wand that vaporized the problems presented by the conflict between police power and the non-impairment clause, thus:

> It must be noted that the application of the reserved power of the State to protect the integrity of the government and the security of the people should be limited to its *proper bounds* and must be addressed to a *legitimate purpose. If these bounds are transgressed, there is no room for the exercise of the power, for the constitutional inhibition against the impairment of contracts would assert itself.* We can cite instances by which these bounds may be transgressed. One of them is that the *impairment should only refer to the remedy and not to a substantive right. The State may postpone the enforcement of the obligation but cannot destroy it by making the remedy futile…Another limitation refers to the propriety of the remedy. The rule requires that the alteration or change that the new legislation desires to write into an existing contract must not be burdened with restrictions and conditions that would make the remedy hardly (worth) pursuing…*In other words, the Blaisdell case postulates that the *protective power of the State, the police power, may only be invoked and justified by an emergency, temporary in nature, and can only be exercised upon reasonable conditions in order that it may not infringe the constitutional provision against impairment of contracts*. As Justice Cardozo aptly said, 'A different situation is presented when extensions are so piled up as to make the remedy a shadow ….' The changes, of remedy now challenged as invalid are to be viewed in combination, with the cumulative significance that each imparts to all. So viewed they are seen to be an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security. *In fine, the decision in the Blaisdell case is predicated on the ground that the laws altering existing contracts will constitute an impairment of the contract clause of the Constitution only if they are unreasonable in the light of the circumstances occasioning their enactment.*[86]

Pursuant to this, the Court examined the totality of the factual circumstances within which R.A. No. 342 operated on the contract between Rutter and Esteban, in order to determine whether or not the effect of the law on the contract could be categorized as unreasonable. In holding that it was, the Court stated that:

> We should not lose sight of the fact that these obligations had been pending since 1945 as a result of the issuance of Executive Orders Nos. 25 and 32

85. *Id.* at 74 (emphasis supplied).

86. *Id.* at 76-77 (emphasis supplied).

> and at present their enforcement is still inhibited because of the enactment of Republic Act No. 342 and would continue to be unenforceable during the eight-year period granted to prewar debtors to afford them an opportunity to rehabilitate themselves, which in plain language means that *the creditors would have to observe a vigil of at least twelve (12) years before they could effect a liquidation of their investment dating as far back as 1941. This period seems to us unreasonable, if not oppressive*...the relief accorded works injustice to creditors who are practically left at the mercy of the debtors. *Their hope to effect collection becomes extremely remote*, more so if the credits are unsecured. And the injustice is more patent when, under the law, the debtor is not even required to pay interest during the operation of the relief, unlike similar statutes in the United States.[87]

The Court further buttressed its ruling by citing various U.S. Supreme Court decisions which voided debt moratorium laws on the ground that the period of relief granted to debtors was not proportionate to the emergency that the laws sought to address. The same was held to be true of R.A. No. 342, as well as the executive orders that complemented them, at least in so far as their further effectivity was concerned, in view of the fact that by the time the Court decided the case, some eight years had passed since the Philippines was liberated from Japanese Occupation, and the economy on a macro as well as micro scale had improved considerably, and was in fact on a continued upswing. Thus, the debt moratorium provided by the law could be considered as "unreasonable and oppressive"[88] to creditors.

The value of *Rutter* lies in the fact that it is the first case which veered away from the rigid doctrine laid down in *Gaspar* and restated in subsequent cases, namely that there are no vested rights in a remedy for enforcement of a contract, but the substantive aspects of the contract are legislatively impregnable. *Rutter* gave judicial imprimatur to the principle that even the very essence of the contract — its "integrity" — and not just the remedy for its enforcement, may be interfered with by the legislature in the exercise of police power. This due to the principle that the sanctity of contracts that the non-impairment clause seeks to protect is predicated on the continued existence of a government that can maintain social order and thus ensure that the compulsive obligation of contracts has true meaning. Such a pronouncement was the initial stroke by the Court in delineating the jurisprudential limits to the once absolute protection of the freedom to contract.

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87. Id. at 77 (emphasis supplied).

88. *Id.* at 82.

Rutter was decided during the same period when jurisprudence began to recognize the wider participation of government in societal affairs,[89] and over the next 20 years, several landmark rulings on the *parens patriae* concept and all-embracing extent of police power,[90] which — while reaffirming the latter's role as the vanguard of public welfare — correspondingly heralded the decline of the non-impairment clause as a valuable tool in protecting vested rights of the individual.

IV. The Subjugation of the Non-Impairment Clause by Police Power

Feati University v. Court of Industrial Relations[91] illustrates the post-*Rutter* jurisprudential environment. Here, faculty members of Feati organized themselves into a labor union and sought to bargain collectively with the management of the school. Upon the latter's refusal to enter into collective bargaining negotiations, the faculty members declared a strike and formed a picket line within the school premises. The defunct Court of Industrial Relations (CIR) then issued a return to work order against the striking employees. However, Feati had already procured the services of replacement professors during the pendency of the strike. Thus, the university assailed before the High Court the constitutionality of the return to work order issued by the CIR, alleging that the order constituted impairment of the obligation of its contracts with the replacements.

In dismissing Feati's claim, the Court first upheld the CIR's power to issue the return to work order, since applicable labor laws on the matter were aimed at empowering the CIR with various means to settle labor disputes, and a return to work order was one such tool. From here, the Court laid down the postulate that labor contracts, such as those between Feati and the replacement teachers, "*must yield to the common good* and such contracts are subject to the special laws on labor unions, collective bargaining, strikes and similar subjects,"[92] the common good in this case being industrial peace, and the power of the CIR to issue return to work orders part of such special labor laws.

Feati embodies the paradigm of contractual rights yielding to police power, the latter in this case being the "common good" equated with

89. *Rutter* was decided in 1953, while *Bacani,* which set aside the once clearly drawn line between the constituent and ministrant functions of government, was decided in 1956.

90. Ermita-Malate Hotel and Motel Operators Association, Inc. v. Mayor of Manila, 20 SCRA 849 (1967); Agustin v. Edu, 98 SCRA 195 (1979).

91. Feati University v. Court of Industrial Relations, 18 SCRA 1191 (1966).

92. *Id.* at 1224 (emphasis supplied).

industrial peace, regardless of whether the contractual rights affected constitute the substance of the agreement or only the remedies for the latter's enforcement. However, the main shortcoming of the case is that it provides only the general framework within which the rulings on the non-impairment clause would operate; it fails to epitomize the classic situation of complete police power dominance: a contract, lawful, valid, and binding in all its terms, is entered into between private parties, and a law is *subsequently* passed which nullifies or otherwise amends the substantive provisions of the contract. In *Feati,* the law was not enacted subsequent to the contract. Rather, the law was merely read by the Court in conjunction with the private agreement. *Philippine-American Life Insurance Co. v. Auditor General*[93] followed a similar path.

Del Rosario v. De Los Santos,[94] however, constitutes the apex of police power superiority. Here, Victorino and Tomas de los Santos, as tenants of Ernesto del Rosario, filed a petition before the defunct Court of Agrarian Relations (CAR), seeking to change their contractual relationship with their landowner from tenants to the leasehold system. Such a petition was grounded on Sec. 14 of the Agricultural Tenancy Act of 1955, which empowered a tenant to "to change the tenancy contract from one of share tenancy to the leasehold tenancy and vice versa and from one crop-sharing arrangement to another of the share tenancy."[95] The CAR brushed aside del Rosario's assertion that the law was an unconstitutional impairment of the obligation of contracts, and thus converted the relationship between the del Rosario as landowner and the de los Santoses as tenants into one of leasehold tenancy. In dismissing del Rosario's appeal and upholding the validity of the law, the Court discussed the public policy behind the Agricultural Tenancy Act, thus:

> Tenancy legislation is a manifestation of the deep and earnest concern to solve an age-old problem that has afflicted Philippine society, with its roots going back to the nineteenth century. The framers of the Constitution mindful of the then growing feeling of dissatisfaction with the ability of the government to cope with the poverty and misery of the vast majority of our people inserted the protection to labor and social justice provisions of the Constitution. Thus they left no doubt-about the validity of remedial legislation intended to minimize, if not to do away entirely with the oppressive condition that usually was associated with agricultural labor. In no sphere of governmental activity then could there be less receptivity to claims on the part of those adversely affected that thereby their property

93. Philippine-American Life Insurance Co. v. Auditor General, 22 SCRA 135 (1968).

94. Del Rosario v. De Los Santos, 22 SCRA 1196 (1968).

95. *Id.* at 1197.

> rights were not given the respect the Constitution affords. More specifically as far as the social justice principle is concerned, there is the translation into reality… The purpose of this Act, according to Section 2 thereof, is 'to establish agricultural tenancy relations between landholders and tenants upon the principle of social justice; to afford adequate protection to the rights of both tenants and landlords, to insure an equitable division of the produce and income derived from the land; to provide tenant-farmers with incentives to greater and more efficient agricultural production; to bolster their economic position and to encourage their participation in the development of peaceful, vigorous and democratic rural communities…The history of land tenancy, especially in Central Luzon, is a dark spot in the social life and history of the people. It was among the tenants of Central Luzon that the late Pedro Abad Santos, acting as a saviour of the tenant class, which for generations has been relegated to a life of bondage, without hope of salvation or improvement, enunciated a form of socialism as a remedy for the pitiful condition of the tenants of Central Luzon. It was in Central Luzon also that the tenants forming the PKM organization of tenants and, during the war, the Hukbalahap, rose in arms against the constituted authority as their only salvation from permanent thraldom. According to statistics, whereas at the beginning of the century we had only 19% of the people belonging to the tenant class, after 60 years of prevailing, the percentage has reached 39%. It is the desire to improve the condition of the peasant class that must have impelled the Legislature to adopt the provisions as a whole of the Agricultural Tenancy Act, and particularly Section 14 [thereof].[96]

In light of these legislative considerations, the Court brushed aside the alleged violation of the non-impairment clause, by holding that:

> *Obligations of contracts must yield to a proper exercise of the police power when such power is exercised, as in this case, to preserve the security of the State* and the means adopted are reasonably adapted to the accomplishment of that end and are not arbitrary or oppressive…It thus appears indisputable that reinforced by the protection to labor and social justice provisions of the Constitution, *the attribute of police power justifies the enactment of statutory provisions of this character. That public interest would be served by governmental measures intended to aid the economically underpriviledged is apparent to all. Nor is the means relied upon to attain such a valid objective unreasonable or oppressive, Considering that in the adjustment or reconciliation of the conflicting claims to property and state authority, it suffices that there be a rational basis for the legislative act,* it is easily understandable why, from the enactment of the Constitution with its avowed concern for those who have less in life, the constitutionality of such legislation has been repeatedly upheld.[97]

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96. *Id.* at 1198-1200.

97. *Id.* at 1200-01 (emphasis supplied).

Thus, the Court established the unrivaled dominance of police power in the clash between overriding public necessity and sacred liberty of contract of the individual. The Court gave its seal of approval to the unilateral change of contractual relations between del Rosario and the de los Santoses, by legitimizing the legislatively mandated change of tenancy relations to leasehold tenancy, on the grounds that a legitimate exercise of the police power of the State constituted more than sufficient basis to alter the vested rights arising from the substantive aspects of the contractual relations between the landowner and his tenants.

So goes the rule even up to the present. A perfectly valid contract may be altered, modified, or voided by a law that is subsequently enacted, wholly or partially, whether in connection with its remedial aspects or the substance of the agreements which it embodies, or even both, provided the law constitutes a valid exercise of police power. The latter takes complete and absolute precedence over any and all individual rights that have been vested by the contract.

There is only one limitation on this rule, namely that the exercise of police power be a valid one. This it is best illustrated by *National Development Co. v. Philippine Veterans Bank*.[98] President Ferdinand Marcos, in the exercise of his legislative powers under Martial Law, issued a Presidential Decree ordering the rehabilitation of the Agrix Group of companies, under the auspices of the National Development Company. Pursuant to such rehabilitation, the Decree unilaterally extinguished any and all liens and mortgages attached to the assets of Agrix, prohibited interest on the unsecured obligations of the latter, and refused recognition of accrued interests, penalties, and charges on secured as well as unsecured debts. The rationale behind these modifications was the protection of the small investors of Agrix. These provisions of the Decree prevented Agrix's creditors from enforcing their rights under their mortgage agreements with the latter.

The Supreme Court nullified these provisions of the Decree, on the ground that it was an invalid exercise of police power, since the two requisites for the latter were absent. First, the public interest in setting aside the terms of the mortgage agreements was not shown, since Agrix was a private company, and thus the only beneficiaries of the Decree would be the company's shareholders, and not the public in general. Neither could there be any public interest in protecting such a small group of individuals. Second, even assuming that public interest was present, the means used were arbitrary. It may thus be readily inferred that if the exercise of police power had been valid, *i.e.*, the requisites for the latter had concurred, the Decree that which destroyed the vested rights of Agrix's creditors would have been upheld,

98. National Development Co. v. Philippine Veterans Bank, 192 SCRA 257 (1990).

regardless of the consequent nullification of the valid and binding mortgage contracts subject of the dispute.

The shift in doctrine by the Court has since been applied in a wide variety of cases, including contracts over real property,[99] zoning laws which affect residential houses, [100] employer-employee relations, [101] contracts pertaining to sugar milling,[102] agreements relating to banking,[103] and many others. The Court's statement in *Philippine Veterans Bank Employees Union v. Philippine Veterans Bank*[104] captures the essence and, more important, the net effect of this new absolutist doctrine: it stated that the contract clause yields to the valid exercise of police power done in the public interest. And public interest is such a broad concept that it has *left the contract clause practically in shambles.*

Conclusion: Finding the Middle Ground

The evolution of jurisprudence into its present form represents a sudden and radical shift by the Court from one extreme to the other — from the Scylla of absolute non-impairment established by *Gaspar* and *Diaz Conde* to the Charybdis of an emasculated contract clause began by *Rutter* and capped by *Philippine Veterans Bank*.

Although there can be no serious argument against the expanded definition of police power and its omnipresence, albeit in various forms and degrees, in virtually all aspects of individual transactions, the inadvertent reduction of the contract clause in the constitution to obsolescence raises serious concerns about not only the sanctity of contracts, but the very concept of civil liberties within which the non-impairment clause operates. As the rule stands now, the individual can expect no protection from legislative interference with his contract, since the only requisite for legitimate interference with the latter, namely a valid exercise of police power, can be easily complied with by the Legislature.

The current doctrine on the matter has made a virtual mockery of the freedom of contract — true, individuals are still free to enter into any

99. Caleon v. Agus Development Corporation, 207 SCRA 748 (1992).

100. Ortigas & Co. v. Feati Bank, 94 SCRA 533 (1979).

101. Abella v. National Labor Relations Commission, 152 SCRA 140 (1987).

102. Hawaiian-Philippine Co., v. Asociacion de Hacenderos de Silay-Saravia, Inc., 88 SCRA 294 (1979).

103. Philippine Veterans Bank Employees Union v. Philippine Veterans Bank, 189 SCRA 14 (1990).

104. *Id.*

contract, with the stipulations and conditions contained therein left entirely to the will of the contracting parties, the only limitation on such being that the terms of the contract are not violative of law, morals, public policy, or public order.[105] However, any and all covenants entered into by the parties pursuant to this principle may be modified or even completely abrogated by a subsequent law that observes the requisites for police power, with no regard whatsoever of vested rights, and the courts will provide no relief to the individual. This "congenital infirmity" in private agreements renders the autonomy of contract moot and academic. This is analogous to a situation wherein the proscription against subsequent punishment in free speech cases is absent — although the individual is free to voice his opinions, the certainty of consequent reprisals from the powers that be effectively nullify any attempt to exercise the right to free speech. In fact, the situation in contracts is worse — because a courageous individual may defy the odds and say his piece regardless of any threatened punishment, while in the case of the non-impairment doctrine, the will of the contracting parties is completely replaced by the legislative intent of a police power law.

However, even a cursory reading of the watershed decisions on the matter will show that this abrogation of the non-impairment clause by the Supreme Court has no doctrinal underpinnings. *Rutter,* which marked the beginning of the shift in outlook of the Court, was based in no small degree on the landmark American case of *Home Building*. The latter, in turn, laid down the fundamental postulate to be observed in the constant tug-of-war between police power and the non-impairment clause, to wit: "The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other."[106] The U.S. Supreme Court's prescribed method of harmonization is to examine the circumstances within which the two constitutional concepts collide, and if such circumstances warrant, as in the case of "a great public calamity such as fire, flood, or earthquake,"[107] then temporary interference on a limited basis is justified. However, the nature and extent of the interference must be proportionate to the public need that it seeks to address. In *Rutter,* the Court undertook a similar balancing test. The length of time (12 years) that the obligation of the debtor to pay the creditor was suspended, vis-à-vis the improved economic conditions of the period (some eight years after liberation and the pronouncements by the executive department on the

105. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE] art. 1306.

106. Home Building & Loan Association v. Blaisdell, 290 U.S. 398 (1934).

107. *Id.*

steady progress of the nation) led to the Court's declaration of the debt moratorium law as unconstitutional.

Be that as it may, cases subsequent to *Rutter* are bereft of any attempt to balance these conflicting principles. Both *Feati* as well as *Del Rosario* limited their analysis to the issue of whether or not the contracts in question could be properly subjected to the exercise of police power. In *National Development Co.,* the Presidential Decree was struck down on the *sole* ground that the exercise of police power was invalid due to the absence of the two essential requisites of the latter. Virtually all succeeding decisions on the contract clause show the Court's complete disregard of the harmonization principle established in *Home Builders* and, ironically enough, adopted in *Rutter*. True, the principle that the power of the State to ensure public welfare cannot be excluded or otherwise limited in any way by the simple expedient of two persons agreeing on such is beyond cavil; *Home Builders,* the same case that established the harmonization principle, acknowledged this much, to wit:

> The reservation of state power appropriate to such extraordinary conditions may be deemed to be as much a part of all contracts… The economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts. Similarly, where the protective power of the State is exercised in a manner otherwise appropriate in the regulation of a business it is no objection that the performance of existing contracts may be frustrated by the prohibition of injurious practices. The question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end.[108]

Thus, in the final analysis, police power, by its very nature and purpose, must necessarily carry greater weight in the constant push and pull between the two fundamental constitutional concepts. Be that as it may, it is imperative, as in all cases wherein conflicting rights are involved, that the Court undertake a rational process, with the use of judicially manageable and consistent standards, of balancing police power and non-impairment, instead of immediately declaring the complete dominance of the former concept, without regard to the factual circumstances of the case or the vested rights of individuals. In *Rutter,* the Supreme Court showed itself capable of undertaking this task, at least in its initial stages. However, the potential growth of the harmonization principle was cut short by the subsequent decisions of the Court which consistently and completely subsumed the non-impairment clause to police power.

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108. *Id.*

It is submitted that the following principles may thus be adopted by the Court to facilitate the harmonization of the two concepts, and thereby offer a rational and consistent process in order to arrive at a well-grounded decision as to the exact extent and degree by which the non-impairment clause should be subsumed to police power, rather than unilaterally abrogating the contract clause on a wholesale basis in favor of police power.

1. *Vested rights should be respected.* As a general rule, to the extent that it may be made possible by the wording of the law, the Court should apply the law prospectively, and not retroactively, in order that vested rights should be respected.

2. *The factual circumstances should be examined.* Given the expansive nature of police power, there are many instances when a police power law requires retroactive, and not merely prospective, application. In such a case, the Court should examine the factual circumstances within which the law is applied and the legislative intent behind its enactment. This will allow it to decide to what extent and degree vested rights must be impaired. The Court did this much in *Rutter* when it examined the economic conditions in the country *vis-à-vis* the purpose of the law, namely the economic rehabilitation of the individual debtor.

3. *Impairment should be minimized.* Should the previous step require impairment of vested rights/interference with the contract, such should be carried out only to the extent necessary to meet the public necessity sought to be addressed by the law. Wholesale and indiscriminate abrogation of contracts, without regard to vested rights, as would probably have been done in *National Development Co.* if the exercise of police power had been valid, should be avoided. Again, the Court's careful examination of the facts in *Rutter* offers an ideal model.

4. *Unnecessary construction should be avoided.* Finally, if the police power legislation is worded in such a manner that it is clear that vested rights must give way, then the Court will have no choice but to allow the non-impairment clause to yield to the exercise of police power, this in order to avoid judicial legislation.

Given the expanded definition of police power and the corresponding expansion of government's role in public life, the value of the non-impairment clause has depreciated considerably. However, to declare it an anachronism by the simple expedient of judicial erosion is to usurp the will of the sovereign; the latter, by ratifying the constitution, have manifested their desire to keep the non-impairment clause intact. Furthermore, at a time when public perception of the Philippine legal system is one of rules which change at the whims of the powers that be, the non-impairment clause offers

a bedrock of stability. True, the application of the aforementioned principles may in fact simply result in the dominance of police power, given that the latter must, in the final sense, carry the day. Be that as it may, their value lies in that they offer a counterweight to the imperious presence of police power, and may thus aid in the much needed resurrection of the efficacy of the non-impairment clause, which has long since been interred by jurisprudence.