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When Do Claims Challenging a Statute’s Effect on Pre-existing Contracts Accrue?

by Lucia A. Silecchia

ISSUES

Does a breach of contract claim accrue for purposes of 28 U.S.C. § 2501 when Congress enacts a statute alleged to abridge a contractual right to freedom from regulatory covenants upon prepayment of government mortgage loans?

Does a Fifth Amendment takings claim accrue for purposes of 28 U.S.C. § 2501 when Congress enacts a statute alleged to abridge a contractual right to freedom from regulatory covenants upon prepayment of government mortgage loans?

FACTS

This litigation arose out of the claims of multiple, similarly situated petitioners who own property used as low-income rental housing and financed by mortgage loans from FmHA pursuant to Section 515 of the National Housing Act of 1949, Pub. L. no 87-723, § 4(b), 76 Stat. 671 (1962) (codified as amended at 42 U.S.C. §1485 (1994)) (“National Housing Act”). The facts most relevant to this case, however, do not concern the actions of the petitioners themselves as much as they revolve around acts of Congress with regard to the evolution of this loan program.

The National Housing Act, as originally conceived, was designed to foster development of public housing programs in rural areas. In 1962, the addition of Section 515 to the National Housing Act (45 U.S.C.
§ 1485) attempted to increase the supply of available low-cost housing by encouraging private parties to begin developing low-income rental housing.

Under the terms of Section 515, the FmHA would lend money to private parties through low-interest mortgage loans. In exchange for these low-interest mortgages—and to further FmHA's primary goal of increasing the availability of low-income rural housing—the borrowers agreed to “regulatory covenants” outlined in their loan agreements.

The terms of these low-interest mortgages lasted up to 50 years. However, under the original loan agreements between FmHA and the borrowers, the loans could be prepaid at any time. This so-called escape hatch freed a borrower of the loan restrictions at any time during the life of the mortgage as soon as the mortgage was paid in full. A borrower who chose to do this could then convert the property to a more commercially valuable use either by renting it out at market rate or selling it for fair market value unencumbered by the restrictions in effect during the life of the loan.

The promissory notes signed by the borrowers provided that such prepayments “may be made at any time at the option of the borrower.” It was believed that this would be in the best interests of all the parties involved: the availability of the low-cost funds would encourage development of low-income housing as desired by the government; the unfettered availability of the prepayment option would help ameliorate the economic losses incurred by borrowers; and the funds prepaid to the government early in the life of the loan would provide it with additional cash to redirect to new housing initiatives sooner than initially planned.

However, the prepayment option seems to have become almost too popular. Because property purchased with the FmHA loans became more lucrative without the restrictions on its use, many owners opted to prepay. As a result, the quantity of low-income Section 515 housing declined. Because this undermined the goals of the National Housing Act, Congress responded to the problem with a number of amendments. It is these amendments—and their impact on the contractual and property rights of borrowers—that are at the heart of this case.

First, in 1979, Congress passed the Housing and Community Development Amendments of 1979, Pub. L. No. 96-153, § 503, 93 Stat. 1134 (1979) (codified as amended in relevant part at 42 U.S.C. § 1472 (1982)) ("1979 legislation"). This 1979 legislation continued to apply the restrictions of the 1979 legislation to loan contracts entered into after the 1979 legislation. However, pre-1979 borrowers were no longer bound by those restrictions that curtailed their right to prepay.

For six years following the 1980 legislation, the FmHA resumed its practice of accepting prepayments from borrowers with pre-1979 loans. However, the need for low-income housing remained great. Thus, beginning October 18, 1986, Congress began a series of moratoriums on accepting loan prepayments for both pre- and post-1979 FmHA mortgage loans. These moratoriums were set to expire on March 15, 1988.

(“ELIHPA”). This legislation, made applicable to both pre- and post-1979 borrowers, mandated that before the FmHA can accept a prepayment from a borrower, it must “make reasonable efforts to enter into an agreement with the borrower under which the borrower, will make a binding commitment to extend the low-income use of the assisted housing and related facilities for not less than the 20-year period beginning on the date on which the agreement is executed.” Id. at § 1472(c)(4)(A).

Furthermore, if no agreement is reached during this “reasonable” time, the FmHA must demand that the owner sell the property at fair market value to a “qualified” nonprofit organization or public agency that promises to maintain the property for low-income housing use. Id. at § 1472(c)(5)(A)(i). It is only after 180 days elapse with no offer to purchase that the FmHA may accept prepayment. Id. at § 1472(c)(5)(A)(ii).

There are two narrow exceptions to this scheme. The first says that the restrictions on prepayment will not apply to those situations in which prepayment will not adversely affect the “housing opportunities of minorities” and the prepaying borrower is “obligated to ensure that tenants of [the property] will not be displaced due to a change in the use of the housing, or to an increase in rental or other charges as a result of the prepayment.” Id. at § 1472(c)(5)(G)(ii)(I). This, in effect, would require that a prepaying borrower retain all current low-income tenants on the property until they voluntarily moved.

The other exception is that the restrictions on prepayment will not apply when prepayment will not adversely affect the “housing opportunities of minorities” and “there is an adequate supply of safe, decent, and affordable rental housing within the market area” of the borrower’s property. Id. at § 1472(c)(5)(G)(ii)(II). Such a finding of adequate low-cost options in the area will allow prepayment and the release of the borrower from the restrictions of the loan.

As originally passed, ELIHPA was dubbed an “emergency” act with a two-year time limit. However, on October 28, 1992, Congress enacted the Housing and Community Development Act of 1992, Pub. L. No. 102-550, §§ 2, 712, 106 Stat. 3681, 3841 (1992) (codified in relevant part at 42 U.S.C. § 1472(c) (1992) (“the 1992 legislation”). This legislation made the ELIHPA restrictions on pre-1979 borrowers permanent and applied them to post-1979 borrowers as well. In the wake of the 1992 legislation, the FmHA then issued implementing regulations that detailed, among other things, how the agency would evaluate whether borrowers seeking prepayment would qualify for the exceptions to ELIHPA.

Petitioners are owners of low-income housing who financed this property with money borrowed under the FmHA’s Section 515 mortgage loan program prior to 1979. At the time they borrowed the money, the petitioners were free to prepay at a time of their own choosing. Petitioners assert that they would not have entered the mortgage loan contracts “but for” this option to prepay, since maintaining the property as low-income housing for the life of the mortgage—a life sometimes lasting as long as 50 years—would be fiscally disadvantageous to them.

Following passage of ELIHPA, the petitioners each decided to terminate their mortgage by exercising the right to prepay as outlined in their original loan agreement.

However, as a result of ELIHPA’s tight restrictions on prepayment, the written prepayment requests made by some of the petitioners were rejected by the FmHA on the grounds that their properties were located in areas that did not meet the “adequate supply” of low-cost housing requirement needed to get an exception to the ELIHPA’s stringent rules. Other petitioners did not file formal written prepayment requests to FmHA because they allege that they were informed that market conditions in their areas would make such requests futile.

Facing the prospect of having their property subject to the loan restrictions for the entire remaining life of their mortgages, the petitioners filed suit in the Court of Federal Claims. Their complaint alleged, first, that the 1992 legislation “anticipatorily repudiated the contract between the [government] and the [borrowers]” and that this repudiation was also a taking under the Fifth Amendment. The petitioners sought monetary damages to compensate them from alleged financial losses that resulted from their inability to prepay their FmHA mortgage loans.

The Court of Federal Claims, however, granted the government’s motion to dismiss the borrowers’ claims on the ground that the statute of limitations for bringing those claims had run. Specifically, 28 U.S.C. § 2501 requires that “[e]very claim of which the United States Court of Federal Claims has jurisdiction shall be barred unless the petition thereon is filed within six years after such claim first accrues.”

In Franconia Assoc. v. United States, 43 Fed.Cl. 702 (1999), the court held that the cause of action for the contract claim accrued in 1988 when ELIHPA was first passed. Because the claims were brought
more than six years after that time, the court dismissed them. In so doing, the court rejected the borrowers' arguments that the 1988 legislation was merely an anticipatory repudiation and that the 1992 legislation—rather than ELIHPA in 1988—was the relevant legislation. The court reached a similar ruling in Grass Valley Terrace v. United States, 46 Fed.Ct. 629 (2000).

With regard to the Fifth Amendment takings claim, the Court of Federal Claims adopted a similar line of reasoning, holding that these claims were also time-barred because they accrued in 1988. Interestingly, the government had not sought dismissal of these property claims. However, the Franconia Court dismissed them sua sponte.

The borrowers then appealed to the U.S. Court of Appeals for the Federal Circuit. In Franconia Associates v. United States, 240 F.3d 1358 (2001), the court of appeals grappled with the issues that will face the Supreme Court. In a February 15, 2001, opinion by Judge Schall, the court affirmed the lower court's dismissal of the petitioners' claims. (On May 17, 2001, the court of appeals also affirmed the lower court's decision in Grass Valley, in a per curiam decision with no opinion.)

The court of appeals relied on Hart v. United States, 910 F.2d 815, 817 (Fed. Cir. 1998), for the proposition that a claim against the United States accrues “when all events have occurred which fix the government's liability.” Defining when “all” of these events have occurred was the task for the court of appeals and remains the task for the Supreme Court.

The court of appeals first rejected the borrowers' argument that their contract causes of action accrued when the FmHA actually rejected their request to prepay rather than when the ELIHPA was passed. Although the borrowers claimed that ELIHPA was merely an anticipatory repudiation, the Court held that because ELIHPA took away the borrowers' previously “unfettered” prepayment right, it was ELIHPA's passage that breached the contract and triggered the statute of limitations on the contract claim. The court relied, in part, on its prior opinion in Ariadne Fin. Servs. v. United States, 133 F.3d 874, 879 (Fed. Cir. 1998), which stated that “[t]he government's liability was fixed when it refused to allow use of the asset it promised.”

The court also rejected the borrowers' alternative argument that it was the 1992 legislation rather than the 1988 passage of ELIHPA that triggered the cause of action for the contract claim. In doing so, the court dismissed the claim that the 1988 statute was merely temporary or interim. In the court's view, while some provisions of the 1988 statute may have been temporary, there “is no ... language to indicate that the restrictions on FmHA loan prepayments were anything but permanent as to pre-1979 borrowers.”

Once the court rejected the borrowers' contract claims, it used a similar analysis to deny their Fifth Amendment takings claims. The borrowers argued that the takings claim was ripe only when an offer to prepay was rejected or proven to be futile. This would have required an analysis of each petitioners' claim to determine when the property interest was actually taken. However, the court took the view that the "property" interest seized here was the contract prepayment right. Because the court ruled that the contract right was breached with the 1988 passage of ELIHPA, it followed that the property interest in these contract rights, if any, was seized at the same time. Thus, the property claims accrued at the same instant as the contract claims—and more than six years prior to the borrowers' suit.

Petitioners filed a Petition for Rehearing En Banc, which was rejected by the Federal Circuit on June 12, 2001. Petitioners then petitioned for certiorari on September 10, 2001, and their petition was granted on January 4, 2002.

**Case Analysis**

In resolving this dispute, the Supreme Court will face the task of defining when contract and property claims accrue against the government. Although this particular suit involves the rights and obligations of the parties to a specific form of contract, the analysis of the Court in this case will have a widespread impact on broader questions, including the status of the government as a contracting party and questions regarding when legislation can amount to a breach of contract or a Fifth Amendment taking.

With regard to the contract claim, the arguments that the Court will hear will likely center on the question of whether the 1988 passage of ELIHPA constituted an "anticipatory repudiation" as the petitioners will argue or a "breach" of contract as held by the lower courts.

Petitioner's position is that the 1988 passage of ELIHPA amounts to an anticipatory repudiation because it was a statement of the government's intent not to perform under the terms of the original contract rather than an actual refusal to do so. Restatement (Second) of Contracts § 250 (1981) defines a repudiation as a "statement by the obligor to the obligee indicating that the obligor..."
will commit a breach that would of itself give the obligee a claim of damages for total breach.” Relying on this, petitioner argues that ELIHPA was an anticipatory repudiation because that legislation, in effect, merely announced that the FmHA would no longer meet its contractual obligations to allow prepayment except under limited circumstances not included in the original contract. However, it was not until the petitioners' requests to prepay were denied or found futile that the contractual obligations were breached. In its arguments, petitioner relies heavily on Mobil v. United States, 530 U.S. 604 (2000), which held “the Government’s communication of its intent to commit [a] breach amounted to a repudiation of the contracts.” Id. at 621.

A finding that ELIHPA is an anticipatory repudiation rather than a breach is an important distinction for statute of limitation purposes. An obligee under a contract for which there is an anticipatory repudiation may bring a cause of action at the time of the repudiation. However, at the obligee's option, the suit can also be delayed until the time when performance should have taken place but did not. Petitioners will argue that they were within their rights to wait until their claims were rejected before bringing suit. In their view, it was only when their prepayment requests were refused or deemed futile that their contracts were breached and only then that the six-year statute of limitations began to run. If the Supreme Court adopts petitioners' view that the government's obligation under contracts was to accept prepayment, then it would follow that there could be no breach until the government refused to accept a particular prepayment.

To support their position, the petitioners will refer to the exceptions in the ELIHPA that allowed some borrowers to prepay upon a finding that there was sufficient low-income housing in their area. Petitioners will claim that this exception requires some agency review before they can know definitively that they will not be able to prepay. Because of this, they will argue that no breach can occur until the agency actually determines that they cannot take advantage of the exception since, until that point, prepayment remains theoretically possible. Petitioners will argue that not until and unless the government refuses to accept a particular prepayment has the agency actually taken action in violation of the contracts.

In addition, petitioners will attempt to persuade the Supreme Court that adopting their arguments regarding the repudiation/breach distinction is required if contracts with the government are to be treated consistently with contracts between private parties. A different outcome, they argue, will create a legal inconsistency that will undermine the government's position as a contracting party.

In contrast, the government will argue that the petitioners' contract claim is rightfully a claim for breach of contract rather than anticipatory repudiation. In making this argument, the government will likely advance the position taken by the court of appeals. This view would define the government's duty under the contracts to be the obligation to allow borrowers complete freedom to prepay at any time of the borrowers' choosing rather than the obligation to accept these prepayments. The original terms of the loan contracts did not require the government to make any decisions about whether or not to accept prepayment; the choice to seek prepayment was entirely in the hands of the borrower. Once ELIHPA was passed in 1988, this changed. The unilateral ability of the borrower to decide when and if to seek prepayment was gone. Thus, it is in the government's interest to argue that taking away this unilateral freedom and right to prepay is what, if anything, constituted the breach. If this is so, it follows that the contract was breached at the instant ELIHPA was passed. Thus, it was at this same time that the cause of action for breach of that contract accrued.

In ruling for the government in the opinion below, the court of appeals held “[t]he government contracted to allow borrowers the unfeathered right to prepay their loans and breached that promise, if at all, through the enactment of ELIHPA. The statute of limitations began to run at the time of the breach, when ELIHPA was enacted on February 5, 1988.” Franconia Associates, 240 F.3d at 1364. Thus, the government's contract case will likely center on convincing the Supreme Court to take a similar view with regard to determining how a breach of contract should be defined.

With regard to the second question—the statute of limitations for the Fifth Amendment takings claim—the Supreme Court will have to define precisely what property interest was taken from the petitioners.

Petitioners will argue that there was a regulatory taking of a distinct real property interest. Specifically, they will argue that ELIHPA was a regulatory taking because it restricted the permissible use of their property. Then, relying on Palazzolo v. Rhode Island, 121 S.Ct. 2448, 2458 (2001); Suits v. Tahoe Reg'l Planning Agency, 520 U.S. 725, 735-39 (1997); MacDoyle Sommer & Frates v. County of Yolo, 410 U.S. 340, 348 (1986); Williamson County Reg'l Planning Comm'n v.
Hamilton Bank, 473 U.S. 172, 193 (1985); and Agins v. Tiburon, 447 U.S. 255, 260-63 (1980), petitioners will argue that because the agency was authorized to grant exemptions to some affected owners, the regulatory taking was not ripe for judicial review until either the agency made a final decision about whether to grant an exemption to each individual owner or it was determined that applying for an exemption would be futile. In the view of the petitioners, any other result would mean, in effect, that a cause of action accrued before it was ripe for judicial review.

In contrast, for the government to convince the Supreme Court to uphold the lower court's decision on the takings issue, it must persuade the Court that the petitioners' takings argument and contract argument are inextricably intertwined because petitioners have no freestanding bases for their takings claim. The government will argue that once the contract claim fails, so, too, should the alleged Fifth Amendment claim.

The court of appeals ruled that the alleged taking was not a seizing of a real property interest at all but, if anything, a seizing of the petitioners' contractual right to prepay without the restrictions imposed by ELIHPA. Relying on United States Trust Co. of N.Y. v. N.J., 431 U.S. 1, 19 n.16 (1977), and Greenbriar v. United States, 193 F.3d 1348, 1356 (Fed. Cir. 1999), the court of appeals ruled that "[c]ontract rights are a form of property that may be appropriated by the government." Franconia Assoc., 240 F.3d at 1365.

The government's case will be strengthened if the Supreme Court affirms this view and finds that the property taking, if any, occurred with the passage of ELIHPA since this event "took away and conclusively abolished a material contract right." Id. at 1366. If the Supreme Court takes this view of the takings claim, then its success or failure will be completely tied to the success or failure of the contract claim rather than any independent analysis.

Hence, if the Supreme Court finds that the contract claim fails, the government will argue that the Fifth Amendment claim must fail too. Furthermore, even if the Supreme Court finds that petitioners do have a valid contract claim, the government is likely to argue that a takings claim will still not arise because contract remedies are sufficient to compensate petitioners for any alleged loss.

SIGNIFICANCE

At first blush, this case appears to consider a narrow procedural issue pertaining only to the jurisdiction of the Court of Federal Claims and the rules governing that court's statute of limitations. However, there are several more significant issues that will be affected by the Supreme Court's ruling in this case.

First, although this issue is not directly before the Court, the ruling in this case will have an effect on the government's efforts to achieve a greater supply of low-income housing. If the Court rules for the petitioners, there will be a financial loss to the government as it either makes amends for alleged damages for breaching pre-1979 loan agreements or allows prepayments that it would prefer not to. On the other hand, if the Court rules for the government, it is possible that in the future, would-be participants in similar loan programs may be deterred from entering into those agreements with the government. If future borrowers perceive that the terms to which they agree are unstable or subject to change too easily, they may seek to invest their money in other ways. The impact of either outcome on the supply of low-income housing may undermine the initial goals of the Section 515 legislation. While it is not up to the Supreme Court to address this broader question—and, indeed, the narrowly framed issues would make it hard for it to do so—it is an issue worth examining once the decision is rendered.

More narrowly, the opinion will be extraordinarily instructive as to the status of congressional legislation as a potential breach of contract or Fifth Amendment taking. By definition, each time Congress enacts legislation, it changes the status quo. The fact that this case is now being heard by the Supreme Court illustrates that the law is still unclear as to the legal impact of legislation that changes the status quo with regard to parties contracting with the federal government. Should a legislative change be considered a breach of contract from the moment of enactment? Should a legislative change impact contract rights only when regulations are issued to implement that legislation? Should a legislative change be considered merely an anticipatory repudiation that will not amount to a breach unless an agency takes action pursuant to the new legislation? If the latter, should legislation be drafted in ways that will eliminate agency discretion on the theory that this will make it more likely that the legislation will be an outright breach rather than an anticipatory repudiation of affected contracts? If so, is it good public policy to provide legal incentives for Congress to pass absolute rules eliminating agency discretion because this will start the statute of limitation on claims sooner? While it is true that this particular case arose within the confines of a particular complex loan program, a well-reasoned and well-explained opinion that explores the precise

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legal effect of legislation on contractual claims will benefit both parties contracting with the government and Congress itself.

This case is also significant in that it provides the Court with a vehicle to address the overlap between breach of contract claims and Fifth Amendment claims. While cases have held that contractual rights constitute property, there appears to be ambiguity as to when these two legally distinct claims should be allowed to coexist when they arise from the same set of facts. The Court may take the position that here the takings claim is completely consumed under the contract claim. Thus, if the contract claim fails, the property claim fails and if the contract claim succeeds, the property claim should still fail because the contract remedies are sufficient to compensate petitioners. A ruling of this nature would significantly undermine the notion that those in petitioners' position have any recognizable or distinct property interest in their contract rights. On the other hand, a finding that this set of facts gives rise to both claims would then raise complex questions as to the difference between breach of contract claims and Fifth Amendment claims. At the very least, this circumstance would require the Court to explain what makes these claims different from each other and why aggrieved parties should be allowed to pursue both. This cause may represent a significant advance in the Supreme Court's takings jurisprudence—regardless of whether it advances or curtails the future scope of Fifth Amendment claims.

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