Money and the Sliding Scale Clause in Contracts

Joseph L. Call
MONEY AND THE SLIDING SCALE CLAUSE IN CONTRACTS

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One of the greatest problems confronting the people of this country is the changing status of the national economy and the problem presented to the consumers by the chronic crisis of inflation.¹

During the depths of the depression, commencing in the early thirties, the United States Congress passed important statutes relating to the currency. On March 9, 1933, the "Gold Hoarding Act" was enacted.² Under this act the Secretary of the Treasury was authorized to confiscate for the United States all gold in the country and in exchange therefor to pay legal tender money of the government (irredeemable paper currency). The act further authorized the President to forbid the payment of gold by the federal government to anyone on account of a debt or contract, and the export of gold to any person abroad.

On May 12, 1933, Congress authorized the President to reduce the gold content of the dollar from its present value of 25.8 grains of gold by not exceeding 50 per cent.³ Pursuant to this authorization and on

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¹ Judge of the Superior Court, Los Angeles County, California.
³ The Agricultural Adjustment Act § 43(b) (2), 48 STAT. 51 (1933),

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January 31, 1934, the dollar was reduced to 59 per cent of its former value, now making the dollar 15 5/21 grains of gold instead of 25.8 grains of gold, its former content.

On June 5, 1933, the United States Congress adopted the joint resolution which carried out the policy of the Agricultural Adjustment Act of May 12, 1933. The salient provision of this joint resolution was as follows:

that (a) every provision contained in . . . any obligation which purports to give the obligee a right to require payment in gold or a particular kind of coin or currency, or in an amount of money of the United States measured thereby, is declared to be against public policy. . . . Every obligation . . . shall be discharged upon payment dollar for dollar, in . . . legal tender . . . (b). As used in this Resolution the term ‘obligation’ means an obligation . . . payable in money of the United States, and the term ‘coin or currency’ means coin or currency of the United States, including Federal Reserve notes and circulating notes of Federal Reserve banks and national banking Associations.

One of the basic functions of the gold standard is to provide an automatic limitation on money expansion, and it is, therefore, nearly axiomatic that once the standard is abandoned an almost unlimited expansion of currency and credit not only becomes possible, but becomes probable. Thus the harbinger of inflation is created. Such was the situation induced in the United States. Monetary history in this country since the enactment of the above legislation has been no exception to these general principles. Since the non-convertibility of currency and legal tender, taxes have risen to the staggering total of over $100,000,000,000.00 for the year 1956, or to approximately one-third of the national product. Federal bonded indebtedness now totals $280,000,000,000.00 with every expectation of increase, with our total indebtedness conservatively estimated at approximately $700,000,000,000.00. In the last two decades this gripping inflation has devitalized the American dollar to 50 per cent

6. Budget Director Maurice Stans in a speech to the Houston Chapter of the American Society of Chartered Life Underwriters stated on April 9, 1958 that the red ink total in the 1958 government year ending June 30th would run at least a billion dollars higher than the $400,000,000.00 deficit estimated in January. He further stated that a large deficit looms for 1959, as well, instead of the planned surplus. Los Angeles Times, April 10, 1958, § 1, p. 2.
7. This $700,000,000,000.00 in obligations is computed as follows:
of its previous purchasing power and on the basis of its present decline threatens within another ten years to depreciate the purchasing power to at least 50 per cent of its present 50 per cent value.

Such fiscal debasement falls full weight upon those who have fixed incomes, those living on annuities, pensions and wages, or from the returns of fixed investments in which stipulated sums are initially invested and are returnable from banks, mortgage companies or similar institutions over a period of years as a result of the investment of initial capital.

It is the purpose of this brief discussion to treat of the feasibility of repayment or payment of money in such a fashion as to neutralize the incertitude of the declining value of the medium of payment which is resorted to or utilized in future performance; the purpose being to insure as nearly as practicable an equal or equitable exchange of funds in future performance which is commensurate with its value at the time of the creation of the obligation, loan, advancement, or extension of credit. Otherwise stated, there should be an equitable and mutual right by both parties to the sameness of convertibility.

With the enactment by Congress of the Joint Resolution of June 5, 1933,\(^8\) it became unlawful not only to contract for the payment of debts and obligations in gold or in a particular kind of coin or currency of the United States but it also prohibited the payment of obligations in currency of the United States measured by gold or measured by a particular kind of United States coin or currency. The effect of this latter provision was to negate what is commonly known as the gold value clause in which the privilege of payment is stipulated to be in such a sum of money as equalizes the standard of value of the gold coin as set by Congress. Thus under the joint resolution and the holdings of the Supreme Court any debt or obligation for payment of money, regardless of covenants to satisfy in gold or the gold equivalent, many be satisfied dollar for dollar by payment in irredeemable legal tender. It is apparent, however, from the wording of the joint resolution that if a standard of exchange or payment is assented to which is not predicated upon gold

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\(^8\) H.R. Res. 192, supra note 5.
or a particular kind of United States coin or currency, or in United States money measured thereby, it would be valid. This obviates to a certain extent the inequitable effects of the prohibition of the gold standard of exchange as decreed by the statute if a practical modus operandi of exchange can be evolved.

Two alternatives might first be considered which may have some practical significance. These are the use of foreign currencies and silver bullion which could be used either as media of payment or standard of value. Both foreign currency and silver bullion are in no wise proscribed by the joint resolution and the question therefore is one of desirability or practicability. However, foreign currencies have shown great instability and decline in value greatly in excess of our own, and silver being free on the open markets of the world, and fully governed by the laws of supply and demand, has considerable fluctuation and oscillation so as to make its value highly empirical.

A third alternative, and one which is not restricted by the joint resolution, is that of contracting with reference to price indices. This involves the selection of certain commodity prices and posting or entering their fluctuation or change of movement.

And in this practice the most practical method comprehends ascertaining the percentage of change of a given amount of a certain commodity or commodities over different periods of time. This gives rise to what is called the "index number" which has been characterized as a "figure which shows the average percentage change in the prices of a number of representative goods from one point of time to another."9

If on this basis certain commodities are indexed and their movement or shift in cost or value combined and then the percentage of change reduced to an average, a relatively reliable standard may be arrived at as to the appreciation of cost of the commodities, and likewise a corresponding decline in the purchasing power of the dollar. Thus by stipulation of the parties if the market value of certain commodities at a certain time is accepted as a basis or standard of value, covenants for reimbursement may be arrived at with reference to future acceleration or inflation in the price structure—or otherwise stated, money due as debt or salary may be made to fluctuate with the purchasing power of money.

For those parties, therefore, who desire to protect themselves against monetary fluctuations that are inflationary or deflationary in nature, the price index method of computation affords some protection against the inequities of currency gyrations and for this purpose there is a wide choice of series or methods of index.\textsuperscript{10} However, without question the most outstanding, persuasive and accredited series of indices published are those prepared by the United States Bureau of Labor Statistics. The basic commodities included in the Bureau's consumer price index are most comprehensive and all-inclusive. It is published both weekly and monthly\textsuperscript{11} and covers the prices of all principal commodities.

The use of the price index in wage stabilization has long been a basic covenant between employer and employee in many wage agreements, and to a great extent equalizes the depreciation of the dollar. The particular index used should lay stress on the retail cost of living, that is, necessities, rents, food, clothing and the like. Of course, it should be remembered that no one single index can be inclusive of the wants and needs of all creditors, and that any standard accepted should give special stress to the retail price of goods ultimately expected for use and coupled with a standard as inclusive as possible. In other words, it is imperative that the economic position of the parties involved or to be involved, must point to the index selected.

The actual method of expression or simple components of an instrument expressing standards of value for payment, or machinery of execution, over a long period of time may be suggested as follows:

On the \textsuperscript{---} day of \textsuperscript{---}, 19\textsuperscript{---}, for value received, the AB Company \ldots promises to pay the bearer such sum of money as is equivalent to the present purchasing power of \textit{One Thousand Dollars} and to pay interest at \textit{Six} per cent per annum \ldots, both principal and interest to be measured by the index number of wholesale commodity prices as hereinafter provided. \ldots

The sum to be paid at the maturity of this bond shall be equal to $1,000.00 multiplied by the latest index number of wholesale commodity prices which has been published by the selected agency ten days or more before payment is to be made, and shall be divided by the index number of wholesale com-

\textsuperscript{10} Among outstanding indices there may be mentioned those appearing in \textit{Business Week} and in \textit{Duns Review and Modern Industry}.

\textsuperscript{11} It is contained in the \textit{Monthly Report Review}, the official publication of the Department of Labor.
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Commodity prices published by the selected agency for the week preceding the week in which this bond is issued. The sum to be paid on each interest date of this bond shall be equal to $60.00 multiplied by the latest index number of wholesale commodity prices which has been published by the selected agency ten days or more before payment is to be made, and shall be divided by the index number of wholesale commodity prices published by the Bureau or other selected agency for the week preceding the week in which this bond is issued.\(^\text{12}\)

It is obviously clear, however, that an instrument framed on these conditions could not meet the conditions of negotiability and from that standpoint would experience the difficulties of non-negotiability.\(^\text{13}\)

There are many contractual relationships in which the economic relationships make most difficult the selection of the price index method of payment. Prominent in this respect would be the obligation to pay of banks, utility and insurance companies. The fact that the earnings and income of these corporate structures is more or less fixed or certain and the assets set without variable fluctuation would make the adoption of the price index procedure extremely difficult and unpractical. In other words the fixation in the corporate income would not be variable with the corresponding obligation to pay as regulated by the stable value clause.

However, the transcending rapidity of decline in the purchasing power of the dollar is necessarily making a price index system of values more and more apparent and necessary even though the inconvenience and impracticability of such payment presents a paradox of awkward, difficult and perplexing problems. When we stop to consider that during the period of time 1946 to 1948 the index of consumer prices rose from 83.4 to 102.8 and commodity prices from 78.7 to 104.4; that from 1950 to 1952 consumer prices rose from 102.8 to 113.5 and commodity prices from 103.1 to 111.6; that from 1955 to 1957 consumer prices rose from 114.5 to

\(^{12}\) The first "Stabilized Bond" in history was set for offering to the public by the Rand Kardex Company of Buffalo, N. Y. in 1925. The keystone provision stipulated that as the index of commodity prices rose the company would pay correspondingly additional dollars for principal and interest, and if there was a depreciation in the index number the company would pay correspondingly less. Variation less than 10% either way were to be disregarded. While the bonds attracted great legal attention they were never finally offered for public sale and upon the absorption of the Rand Kardex Company by Remington Rand, Inc. the proposed issue was offered as preferred stock and ordinary bonds. See Fisher, Stable Money 112 (1934).

\(^{13}\) Such an obligation is not a "promise or order to pay a sum certain in money". See Uniform Negotiable Instruments Law § 1.
121 and commodity prices rose from 110.7 to 118.4,\textsuperscript{14} and that since 1939 our total supply of money has increased by 280 per cent,\textsuperscript{15} it must be remembered that the depreciation in the dollar value is corresponding and the necessity of the price index as a value standard is no longer visionary or spectral but an exigency and crisis of the most serious moment.\textsuperscript{16}

In conclusion it should be fairly stated that this short analysis is a treatment of the symptoms of inflation and not of its cause. A debate of the principles of economics that are responsible for our economic maladjustment and its infiltrating ramifications is not herein intended. The fact is, however, that we are in inflation and that it is approaching major proportions, and when this occurs on a large scale the value of money drops faster than the quality of money can be maintained. This creates a deceitful veil of illusion that throws confusion and deceit on everyone.

\textsuperscript{14} Bureau of Labor Statistics indices.
\textsuperscript{16} This is further illustrated by the fact that the total cash expenditures of the federal government for 1957 were in excess of $79,000,000,000.00. This is higher than any other year since World War II. It was $7,000,000,000.00 more than in 1956 and $9,000,000,000.00 more than in 1955.