1982 WL 608787 (U.S.) (Appellate Brief)
Supreme Court of the United States.

ENERGY RESERVES GROUP, INC., Appellant,
v.
THE KANSAS POWER AND LIGHT COMPANY, Appellee.

No. 81-1370.
October Term, 1982.
August 16, 1982.

On Appeal from the Supreme Court of Kansas

(sic)Motion for Leave(sic) to File Brief Amicus Curiae and Brief of Amicus Curiae

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***I MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE**

Comes now, the Corporation Commission of the State of Oklahoma and moves the Court for leave to file the attached brief *amicus curiae* to this case, pursuant to Supreme Court Rule 36.4. As this brief is being filed on behalf of the Oklahoma Commission by and with the Attorney General of the State of Oklahoma pursuant to Supreme Court Rule 36.4, consent of the attorneys for Appellant and Appellee is not required.

The Oklahoma Corporation Commission regulates natural gas from the preliminary stages before drilling (52 O.S. 1981, §87.1) to the method and rates of home and industrial delivery (17 O.S. 1981, §151 *et seq.*). The Commission has the responsibility to make category determinations under the federal Natural Gas Policy Act of ***ii** 1978 (NGPA) (15 U.S.C. §3301 *et seq.*) and administers and enforces the Oklahoma Natural Gas Price Protection Act (52 O.S. 1981, §260.1 *et seq.*) (Oklahoma Act).

The Kansas Natural Gas Price Protection Act (K.S.A. §55-1401 *et seq.*) (Kansas Act) was patterned after and is substantially identical to, the Oklahoma Act. The determination of the constitutionality of the Kansas Act in this case will have a substantial impact on the determination of the validity of the Oklahoma Act. The members of the Corporation Commission are the named defendants in an action questioning the constitutionality of the Oklahoma Act in the United States District Court for the Western District of Oklahoma (*Energy Consumers and Producers Association, et al. v. Baker, et al*, W.D.Ok., Civ. Nos. 79-320-D and 79-823-D). Briefing is complete in the Oklahoma case, but no decision on the merits has been rendered.

Natural gas is a very significant source of energy in Oklahoma. This significance led to an early sensitivity on the part of Oklahoma state legislators to the impact of the NGPA on Oklahoma gas prices.

Since gas prices are so significant in Oklahoma, the impact of a declaration that the Kansas Act is constitutional, or otherwise, will have immediate impact in Oklahoma. Early estimates indicated as much as $994,345,520.00 would be saved by Oklahoma utility ratepayers by operation of the Oklahoma Act through 1985 (Exhibit "55", *Energy Consumers and Producers Ass'n v. Baker, supra*. Stipulation 3). Conversely, that is the amount of potential liability the ratepayers would have if the Oklahoma Act were declared unconstitutional, for that Act requires ***iii** the pass-through of unpaid prices to the ratepayer (52 O.S. 1981, §260.12).

All of the foregoing makes the decision in this case very important to the Oklahoma public and the Oklahoma Commission. The Oklahoma Commission's familiarity with the origin and purpose of the Oklahoma Act may provide some additional insight to the Court in disposing of the pending appeal.

Respectfully submitted,

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***1 No. 81-1370**

In the Supreme Court of the United States

OCTOBER TERM, 1982

ENERGY RESERVES GROUP, INC., *Appellant,*

v.

THE KANSAS POWER AND LIGHT COMPANY, *Appellee*.

On Appeal from the Supreme Court of Kansas

BRIEF AMICUS CURIAE OF THE OKLAHOMA CORPORATION COMMISSION, BY AND WITH THE ATTORNEY GENERAL OF OKLAHOMA

STATEMENT OF INTEREST OF AMICUS CURIAE

The interest of the Oklahoma Corporation Commission, appearing by and through the Attorney General of Oklahoma, is set forth in the accompanying Motion for Leave to File Brief *Amicus Curiae*.

STATEMENT OF FACTS

In order to understand the Kansas Natural Gas Price Protection Act (Kansas Act) (K.S.A. §§55-1401 - 55-1415, Supp. 1981) and the Oklahoma Natural Gas Price Protection Act (Oklahoma Act) (52 O.S. 1981, §§260.1-260.13), this Court needs to know some of the basic history of natural gas regulation. It will be useful to have a brief chronological ***2** overview of the conditions which led to the enactment of the Natural Gas Policy Act (NGPA) (15 U.S.C. §3301 *et seq.*). The legislative history of the NGPA and the Oklahoma Act can provide insight on the questions of constitutional law presented in this case. Some of the events occurring after the passage of the Oklahoma Act also have significance for this case.

1. Natural Gas Regulation Before the NGPA

Shortly after Oklahoma became a State in 1907, the Oklahoma Corporation Commission was given wide powers to regulate gas and gas pipelines. This law, passed in 1913, also gave the Commission the power to establish prices in cases of dispute, and minimum prices to prevent waste, 52 O.S. 1981, §§233 - 234.

The federal government became involved in the pricing of natural gas with the passage of the Natural Gas Act (NGA) in 1938 (15 U.S.C. §§717 - 717w). The federal law established utility-type proceedings for interstate pipelines, including certificates of convenience and necessity. The Federal Power Commission (FPC) administered the NGA, and in 1939 required pipelines to show long-term contracts in order to obtain a certificate. [1] The first price escalation provisions in gas contracts have been attributed to this government action. [2]

* Counsel of Record

1 *In the Matter of Kansas Pipeline and Gas Co. and North Dakota Consumers Gas Co.*, 2 FPC 29 (1939).

***3** In 1950, this Court rejected challenges to the Oklahoma Corporation Commission's exercise of price control over intrastate prices, *Cities Service Gas Co. v. Peerless Oil and Gas Co.*, 340 U.S. 179 (1950). Four years later, this Court issued the landmark *Phillips Petroleum v. Wisconsin* decision, 347 U.S. 672 (1954), which held that the FPC had jurisdiction over the wellhead price of natural gas sold in interstate commerce.

The FPC tried to establish these prices by company-by-company determinations, but soon had an enormous backlog. [3] In 1960, the FPC abandoned that approach, and attempted to produce an "area rate" for producing regions. [4] In 1961, indefinite price escalator clauses in interstate contracts were found to be contrary to public policy. [5] This Court sustained the FPC in that determination in *FPC v. Texaco, Inc.*, 377 U.S. 33 (1964). In 1965, the first "area rate" case was completed for the Permian Basin, and this Court sustained the FPC's use of area rate proceedings, and found that there was substantial evidence "that in design and function [indefinite price escalator clauses] are incompatible with the public interest", *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

2 4 Williams & Meyers, Oil and Gas Law, §726 (1981) as explained in Williams and Meyers, there are several kinds of escalation clauses. Basically, there are definite escalator clauses (which increase the contract price by a fixed amount), and indefinite escalator clauses (which increase the contract price based on some factor outside the contract. Williams and Meyers explain and give examples of the several types of indefinite price escalator clauses, including most favored-nations clauses, third-party most-favored-nation clauses, and spiral escalation clauses.

3 See J. Landis, Report on Regulatory Agencies to the President-Elect, reprinted in Staff of Senate Comm. on the Judiciary, Report on Regulatory Agencies to the President-Elect, 86th Cong, 2nd Sess., at 55 (1960).

4 Permian Basin Area Rate Proceeding, 34 FPC 159 (1965).

***4** The long lag between the initiation and conclusion of FPC hearings establishing rates led to substantially lower prices in the federally-regulated interstate market than in the unregulated intrastate market. This caused severe shortages on the interstate

market. Finally, in the Winter of 1976-1977, there were 75 gas-shortage related deaths and two million workers laid off. [6] This natural gas crisis led President Carter on April 20, 1977, to call for permanent price controls on all natural gas production, as part of an energy program he called the "moral equivalent of war". [7] In 1977, the New Mexico Legislature responded with the New Mexico Natural Gas Pricing Act, [8] which restricted the operation of indefinite price escalator clauses in that state.

5 Pure Oil Co., 25 FPC 383 (1961).

6 Wall Street Journal, Feb. 1, 1977, page 1, col. 3.

7 Reprinted at 123 Cong. Rec. H3328 (daily ed., April 20, 1977).

2. The Creation of the Natural Gas Policy Act

After President Carter's speech, the President's plan was introduced in both the House of Representatives [9] and the Senate. [10] The House approved the President's plan on August 5, 1977. [11] The Senate, however, adopted a substitute plan put forth by Senators Pearson and Bentson on October 4, 1977. [12] The House bill extended permanent ***5** price controls to the intrastate market. The Senate plan set interim price ceilings pending phased-in deregulation. The Senate bill would have *increased* producer revenues by sixty to seventy-five billion dollars during the period from 1977 to 1985. The House Bill would have *reduced* producer revenues by at least fourteen billion dollars during the same period. [13]

8 N. Mex. Stat. Ann., §67-7-2 to -9 (1977).

9 H. R. 8444, 95th Cong., 1st Sess. (1977).

10 S. 1469, 95th Cong., 1st Sess. (1977).

11 123 Cong. Rec. H8826-27 (daily ed. Aug. 5, 1977) (Roll No. 513). The vote was 244 to 177.

12 123 Cong. Rec. S16323-25 (daily ed. Oct. 4, 1977). The vote was 50-46.

With the two bodies divided so widely, both bills went to a Joint Conference Committee. On May 23, 1978, the House Conferees narrowly agreed to an agreement in principle, after adopting modification proposed by Rep. Eckhardt of Texas explicitly protecting the state's rights to control indefinite price escalator clauses. [14] The agreement explicitly provided:

13 Proposed Joint Explanatory Statement of the Committee in Conference on H.R. 5289, "Economic Analysis of Conference Agreement" (July 31, 1978). See Ligon, "Problems of Contractual Authorization to Collect NGPA Wellhead Prices", 57 Tex. L. Rev. 551, 552 (1979), hereinafter referred to as "Ligon, 'Problems"'. This article is the only apparent source for some of the inside history of the NGPA.

"C. State authority to limit or prohibit the operation of any indefinite price escalator clause or limit their effect, *e.g.*, through a state-imposed ceiling price (see Part XVI.A.) would not be preempted, *i.e.*, State may prescribe more stringent limitations on the operation of such clauses than those prescribed herein." [15]

14 Ligon, "Problems", *supra* note 13, at 553, fn. 18. This was specifically to protect the New Mexico statute and any similar statutes, Natural Gas Policy Act Information Services, ¶602:901 (1979).

***6** The House proposal with the Eckhardt amendment was approved by the Senate Conferees on May 24, 1978. [16]

15 Staffs of House Comm. on Interstate and Foreign Commerce and Senate Comm. on Energy and Natural Resources, 95th Cong., 2d Sess., Natural Gas Pricing Agreement Adopted by the Conferees on H.R. 5289 (Comm. Print No. 95-55, 1978) p. 18.

The final version of the bill with major modifications, was released by the Conference on August 16, 1978, with an important Conference Committee explanation attached. [17] With regard to states' power to set prices, Section 602 of the bill provided:

16 Ligon, "Problems", *supra* note 13, at 553, fn. 18. The vote was 10 to 7.

"Nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under title I of this Act."

In the Conference Committee Report, the Conferees explained the meaning of this provision:

> "The conference agreement provides that nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for sales of gas in intrastate commerce which does not exceed the applicable maximum lawful price, if any, under Title I of this Act. This authority extends to the operation of any indefinite price escalator clause. The Congress enacts this provision with a recognition that it is ceding its authority under the commerce clause of the Constitution to regulate prices for such production to affected States." [18]

17 Joint Explanatory Statement of the Comm. on Conference, H.R. Rep. No. 1752, 95th Cong., 2d Sess.; S. Rep. No. 1126, 95th Cong., 2d Sess.; *reprinted* in [1978] U.S. Code Cong. & Ad. News 9041. Both reports are identical.

***7** Similarly, the Conferees explained Section 105 of the NGPA by noting the Congress had specifically limited the operation of indefinite price escalators:

> "The conference agreement specifically prohibits prices paid in any sale of high-cost natural gas from triggering the operation of any indefinite price escalator clauses. The conference agreement also cedes the Federal Government's authority to further limit the operation of indefinite price escalator clauses to State governments wishing to do so. The Congress, by adoption of this section, recognizes the right of States to prescribe more stringent limitations on the operation of such clauses than those prescribed herein." [19]

18 Senate and House Reports at 124-25 (1978).

On September 27, 1978, the Senate passed the NGPA by a vote of 57-42. [20] The Carter Administration decided to back the bill, and on October 13, 1978, the House agreed by one vote on a crucial procedural motion to consider the National Energy Act as a package. [21] On the last day of the 95th Congress, October 15, 1978, the House approved the entire energy package. [22] President Carter signed the energy acts, including the NGPA, on November 9, 1978. [23]

19 *Id*., at 83 (1978).

20 124 Cong. Rec. S16265 (daily ed. Sept. 27, 1978).

21 124 Cong. Rec. H12819 (daily ed. Oct. 13, 1978).

22 124 Cong. Rec. H13426-27 (daily ed. Oct. 15, 1978). The vote was 231 to 168.

The provisions of the NGPA are explained at length in the other briefs in this case, so Oklahoma's discussion can be very brief. "Old" intrastate gas was placed under federal regulation, and had a ceiling set by 15 U.S.C. §3315 ***8** at the lower of the contract price or the "New" gas price ceiling set by Section 102 (15 U.S.C. §3312). Depending on the exact language of the contract, indefinite price escalator clauses would raise the contract price to the highest permitted price, the 102 price. The 102 price goes up each month by operation of an "inflation adjustment factor", plus a percentage bonus of 3.5 percent (before April 20, 1981) or 4 percent (after April 20, 1981).

The 109 price is also significant for this case because that ceiling is the one picked by the Oklahoma and Kansas Legislatures. The 109 price is a miscellaneous "other" gas provision which took the highest price of "old" interstate gas and added the inflation adjustment factor each month (15 U.S.C. §3319). Each of these prices becomes significant in the discussion to follow.

3. The Creation of the Oklahoma Natural Gas Price Protection Act

The Brief of the Energy Reserves Group goes into the legislative history of the Kansas Act in great detail, in a vain attempt to make this case appear similar to *Allied Structural Steel v. Spannaus*, 438 U.S. 234 (1978). The Oklahoma experience in formulating the pattern of the Kansas Act thus becomes important. Even if the attempt to make the Kansas facts fit the *Allied Steel* mold were successful, a consideration of the *entire* history of the Oklahoma Act destroys the theory that this case is at all similar to *Allied Steel*.

On May 24, 1978, the United States Conferees agreed to the House agreement in principle, including the explicit recognition of state power over indefinite price escalator ***9** clauses offered by Representative Eckhardt of Texas.[24] On May 30, 1978,[25] Oklahoma State Senate President Pro Tempore Gene Howard[26] called a press conference to urge the Governor to call a special session of the Oklahoma Legislature. The purpose of the special session was to limit the effect of the NGPA on Oklahoma escalator clauses.

23 124 Cong. Rec. H13704 (daily ed. Nov. 15, 1978).

24 See fn. 16 and accompanying text.

25 This date and other dates in 1978 are derived both from contemporary news accounts in the *Oklahoma Legislative Reporter*, a privately-published newsletter of limited distribution which comprehensively covers Oklahoma governmental affairs, and the memory of the author of this brief, who worked for the Oklahoma Legislature in 1978 and 1979, as a legislative draftsman and was personally involved in the drafting of Senate Bill 49 and related bills.

On September 15, 1978, about a month after the release of the Joint Conference Committee report in Congress, Senator Howard presented a proposal to the Executive Committee of the State Legislative Council,[27] once again calling for action on the problem of indefinite price escalator clauses. The Executive Committee took no action.

26 The President Pro Tempore is the highest officer in the Oklahoma State Senate. Unlike other states and the United States Senate, the President Pro Tem actually is the most powerful senate officer in Oklahoma.

On October 4, 1978, Governor David Boren created a 15-member "blue ribbon" committee composed of his energy advisers, and representatives from the gas industry, the utilities, and academia. The task of the committee was to study the NGPA, assess its effects on Oklahoma, recommend ***10** any actions that Oklahoma could take, and advise the Governor on the need for a special session.

On November 15, 1978, the Special Committee voted not to recommend a special session, since the regular legislative session was so close. On November 29, Speaker of the House Dan Draper joined Senator Howard in urging a special session. On December 6, 1978, Governor Boren announced he would not call a special session and transmitted the work of the special committee to incoming Governor George Nigh.

The Oklahoma Legislature convened on January 2, 1979. Senate Bill No. 49 by Howard and Draper was introduced, limiting escalator clauses to the 109 price.[28] House Bill 1107 by Representative Wiseman and Senator Cate was introduced in the House the next day.[29] The Wiseman-Cate bill imposed a one-year moratorum on the operation of escalator clauses, with limited increases after that time. On January 9, the relevant House and Senate Committees held separate hearings on their respective bills. Several witnesses appeared before both committees, both in favor of and opposing the legislation. On January 15, House Bill 1206 by Hobson and 1212 by Wiseman were introduced.[30] Both bills would have vested the Oklahoma Corporation Commission with the task of making category determinations under the NGPA. Both bills were strongly favored by producers, who could not obtain higher prices for their wells until their category was established.

27 The Executive Committee of the State Legislative Council was composed of the "leadership" of both houses who met during the interim between sessions of the Legislature to study and discuss legislative action for the upcoming legislature.

28 Oklahoma Senate Journal, January 3, 1979.

29 Oklahoma House Journal, January 4, 1979.

***11** On February 6, the Oklahoma Senate passed S.B. 49 by a vote of 32 to 14, after several floor amendments.[31] On March 8, SB 49 was adopted by the House of Representatives with a vote of 58 to 40 on the bill and a vote of 68 to 31 on the separate declaration of an emergency.[32] The Senate concurred in House amendments on March 13, 1979 by a vote of 26 to 18 on the bill, and a vote of 32 to 11 on the emergency.[33] Governor George Nigh signed both HB 1206 and SB 49 into law on March 19, 1979.

30 *Id*., January 15, 1979.

31 Senate Journal, February 6, 1979.

32 House Journal, March 8, 1979. The separate vote on the emergency is required by Oklahoma Constitution, Article V, §58, which requires a two-thirds majority of each house to make a bill effective immediately upon approval by the Governor.

The Oklahoma Act closely tracked the NGPA as passed by Congress. The definitions were lifted verbatim from the NGPA. New gas was allowed to go to the 102 price, and "stripper" gas was allowed to go to the 108 price for the same type of wells (52 O.S. 1981, §260.5). The only limits in the bill were placed on indefinite price escalator clauses in contracts for old intrastate gas (52 O.S. 1981, §260.3). Those clauses were restricted in operation to take the price to the 109 price (52 O.S. 1981, §260.5). Parties were given the ability to renegotiate voluntarily the pricing provisions of their contracts (52 O.S. 1981, §260.8). The Oklahoma Corporation Commission was required to monitor the effect of the Act and report annually to the Legislature until the Act expired on December 31, 1984 (52 O.S. 1981, §260.13).

***12 4. Events After the Passage of the Oklahoma Natural Gas Price Protection Act**

Natural gas producers wasted no time in challenging the Oklahoma Natural Gas Price Protection Act (S.B. 49). One day after it was signed into law, suit for declaratory judgment was brought in the United States District Court for the Western District of Oklahoma, with the style *Energy Consumers and Producers Association v. Baker*, Civ. 79-320-D. A week later a similar suit was brought in the United States District Court for the Northern District of Oklahoma, *Oklahoma Independent Petroleum Association v. Baker*, Civ. 79-C-174-C (March 27, 1979). The cases were later consolidated in the Western District and are still pending.

On February 6, 1979, S.B. 252 had been introduced in the Kansas Senate (coincidentally the same day S.B. 49 was passed by the Oklahoma Senate). On April 25, 1979, the subject of this litigation, H.B. 2680 was introduced in the Kansas House. On May 14, 1979, the Kansas Act was approved by the Kansas Legislature.

On November 24, 1980, the validity of the Kansas Act was upheld in *Edmiston v. State Corporation Commission*, No. 79-1335 (D. Kan. Nov. 24, 1980) *modified* (D. Kan. Jan. 13, 1981), *appeal docketed* No. 71-1197 (10th Cir. Feb. 23, 1981). On July 17, 1981 the Kansas Supreme Court upheld the validity of *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 230 Kan. 176, 630 P.2d 1142 (1981).

***13 SUMMARY OF ARGUMENT**

The question in this case involves the validity of the Kansas Natural Gas Price Protection Act in light of a constitutional challenge based on the Contract Clause, Article I, Section 10, United States Constitution. Previous decisions of this Court have listed several factors useful in determining whether a given legislative action is valid under the Clause. First, the Court must determine whether a substantial impairment of the contractual relationship occurred at all, *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978), with the severity of the impairment measuring the "height of the hurdle the state legislature

must clear", *Id*. at 245. If the legislation is in response to an unforeseen development which alters the manner in which the original contract provisions impact upon the public interest, that is a factor in favor of the legislation's validity, *Home Building and Loan Association v. Blaisdell*, 290 U.S. 398, 426 (1934); *El Paso v. Simmons*, 379 U.S. 497, 515 (1965). The act must address a legitimate public end, not the mere advantage of particular individuals, *Blaisdell*, 290 U.S. at 445; *Allied Steel*, 438 U.S. at 250. A factor in assessing both whether the contract was impaired and the end was legitimate is the existence of state regulation of the general subject-matter at the time the contract was made, *Veix v. Sixth Ward Building and Loan Association*, 319 U.S. 32, 38 (1940); *Allied Structural Steel*, 438 U.S. at 250. The legislation must have reasonable conditions and be of a character appropriate to the public purpose, *United States Trust Co. v. New Jersey*, 431 U.S. 1, 22-23 (1977). Finally, it is a factor in the act's favor if it is of temporary duration, *Blaisdell*, 290 U.S. at 447; ***14** *Allied Structural Steel*, 438 U.S. at 250. Utilizing these tests in this case leads to the conclusion that both the Oklahoma and Kansas Acts are valid exercises of the states' police powers and should be sustained by this Court.

(a) The contract provisions in this case were not severely impaired by the Kansas Act. The Constitution protects the expectation and reliance interests of the parties to a contract. In this case, the contracts specifically contemplate state action and the parties expressly incorporated any changes in state law into their contract.

(b) This Court traditionally grants great deference to the legislative judgment in passing laws regulating the economic affairs of a state. This deference should be extended to the legislatures of New Mexico, Oklahoma, and Kansas, who fought over and passed price protection acts for the benefit of their citizens.

(c) The Oklahoma and Kansas Acts were in response to an unforeseen and unforeseeable revolution in the matter in which the federal government treated intrastate natural gas prices. The NGPA was a radical renewal of federal policy, which altered the effects of private contracts on the public interest. Oklahoma and Kansas met this unforeseen political action of Congress with political action of their own, to minimize the effects of the NGPA revolution.

(d) The Oklahoma and Kansas Acts were enacted to deal with broad, generalized economic problems. This case has little in common with *Allied Structural Steel*, 438 U.S. 234 (1978), in which only narrow, limited interests were served. Both states have a substantial interest in natural ***15** gas and the impact of the price of natural gas. The Oklahoma and Kansas Legislatures also had a legitimate purpose in preventing an unearned and unjustified windfall to producers from the increase of prices for old natural gas. Both of these purposes were recognized as legitimate by the United States Congress when it passed the NGPA, and expressly provided that states could regulate the price of intrastate gas.

(e) At the time of the contract, the area of natural gas regulation was already one in which Oklahoma and Kansas were active. Persons in the industry know they are subject to further state regulation. The parties in this case clearly reflected in their contracts the fact that they knew they were subject to further state regulation. This demonstrates both the amount of impairment of the contracts is low, and that this area of regulation is a legitimate one for state action.

(f) The Acts in question have reasonable conditions and are of a character appropriate to their public purpose. The Oklahoma and Kansas legislatures are the primary judges of the reasonableness of their actions. Actions restraining the operation of indefinite price escalator clauses to a gradual increase is a reasonable response to the goals of protecting ratepayers and preventing windfalls. Such clauses have not been looked upon with favor by either regulators or courts, and it is in the public interest to modify them in a reasonable manner.

(g) Finally, both the Oklahoma and Kansas Acts are temporary in nature, expiring December 31, 1984. That is the scheduled expiration date of the unforeseen event they ***16** were designed to meet, *i.e*., the NGPA. This temporary operation means that producers can look forward to a fixed day that they will be free of *state* price regulation.

Reviewing all of the factors this Court has utilized in the past, it is clear that the Kansas Act is not a law impairing the obligation of contracts as prohibited by the Contract Clause of the United States Constitution. This Court should affirm the decision of the Kansas Supreme Court.

ARGUMENT

I. THE KANSAS ACT DOES NOT CONSTITUTE A SUBSTANTIAL IMPAIRMENT OF THE CONTRACTUAL RELATIONSHIP BECAUSE THE RELIANCE INTERESTS OF THE PARTIES WERE NOT FRUSTRATED.

In determining Contract Clause disputes, "the first inquiry must be whether the state law has, in fact, operated as a substantial impairment of a contractual relationship", *Allied Structural Steel*, 438 U.S. at 244. The analysis of this Court in that case reveals this Court looks to the expectation and reliance interests of the parties to the contract in assessing the amount of impairment. The foundation of the Contract Clause is that "government must keep its word" [34] and the parties are entitled to form their expectations of the basis of that word. If we examine the contract in this case from the viewpoint of what ERG reasonably expected at the time of the contract, it becomes clear that this contract was not impaired by the Kansas Act at all.

33 Senate Journal, March 13, 1979.

***17 A. The Expectation of the Parties Included Future State Legislation.**

The basic starting point for an assessment of the impairment of a contract should be the words of the contract itself. In its brief, ERG is notably silent about the exact terms of its contract. An examination of those clauses reveals why. At the time of contracting both parties anticipated further state legislative action with regard to the terms of the contract, and incorporated any such future changes into their expectations. The relevant contract provisions read:

"6.7 [8.5]. If any federal or Kansas regulatory or governmental authority having jurisdiction in the premises shall at any time hereafter fix a price per MCF applicable to any natural gas or any vintage produced in Kansas, higher than the contract price then in effect under this gas contract, the price to be paid for gas thereafter shall be increased to equal such regulated price. In that event, the increased price shall be effective as of the date of action of the governmental or regulatory authority establishing the regulated price, or its effective date, which ever is later, subject to the provisions of Section 8 [Section 10] hereof. [35]

34 Tribe, *Constitutional Law*, p. 470 (1978).

"18 [20]. GOVERMENT REGULATIONS

"18.1 [20.1]. This gas contract shall be subject to all relevant present and future state and federal laws, decisions of any courts of law and equity, and all rules, regulations, and orders of any regulatory authority having jurisdiction. Neither party shall be held in default for failure to perform hereunder if ***18** such failure is due to compliance with such laws, decisions, rules, regulations, or orders. This section will not operate to affect the rights and options granted to either party as provided for in Section 8 [Section 10] of this gas contract." [36]

35 Appendix to the Jurisdictional Statement, p. 66a (hereinafter referred to as J.S. A-p. §8).

These clauses clearly contemplate future state or federal regulation, including price regulation. The parties can have no expectation regarding the stability of state law when they expressly contract for changes in that law. The contract "contemplates exactly what came to pass" [37] and thus the state action did not impair the obligation of the contract. [38]

36 *Id.*, pp. 69a-70a.

37 *National Building v. State Board of Education*, 85 N. Mex. 186, 510 P.2d 510, 512 (1973).

Chief Judge Frank Theis examined these very contract terms and the authorities and concluded that these contracts "fail to present a contract clause challenge", *Edmiston v. State Corporation Commission*, No. 79-1335 (D. Kan. Nov. 24, 1980), *slip opinion%i, p.7;* see *discussion pages 4-7.* [39]

38 *See also Vogel v. Tenneco Oil Co.*, 465 F.2d 563 (1972); *Austin v. Bennefield*, 140 Ga. App. 96, 230 S.E.2d 16 (1976).

The parties to a contract may agree with each other that the restraints of the contract will vary as the state law varies. The state becomes, in essence, a third party to the contract, with the power to unilaterally alter the terms of the contract. In such a case, it is impossible for the state ***19** to impair the obligation of the contract. In this case, this Court should conclude that the Kansas Act was part of the expectation of the parties, and the contract is not impaired.

B. The Expectation of the Parties Did Not Reasonably Include the Section 102 Price.

ERG claims it "had every expectation that the price would continue to go up in the years to come" (Appt's Br. 25) citing other energy sources and the prospect of deregulation. ERG misstates the interest protected by the Contract Clause. Under the proper interpretation, the question is what the reasonable expectation of the parties was based upon the law at the time, as expressed in the contract. Under the contract, ERG could only expect an increase if some governmental authority established a price in Kansas higher than $1.50 plus 2 [a year per MCF. [40] Even three years later, just before the NGPA, the national rate set by the FPC was still only $1.42 plus 1[a quarter per MCF. [41] The FPC national rate at the time of the contract was substantially less. [42] It was impossible even for very sophisticated observers to predict any future increases under the Natural Gas Act. [43] Thus, *even if* the law had stayed *exactly the same*, ERG had no fixed expectation interest.

39 Hereinafter cited as "*Edmiston*, p. 7". Judge Theis modified his opinion on Jan. 13, 1981 regarding the retroactive effect of the Kansas Act. *Appeal docketed*, No. 71-1197 (10th Cir. Feb. 23, 1981).

40 Sections 6.1 and 6.7 [8.1 and 8.5] J.S. App. 66a.

41 F.P.C. Opinion 770-A, November 5, 1976 (18 C.F.R. 2.56a).

42 Opinion 669-H, December 4, 1974, 52 F.P.C. 1604.

ERG intimates that it expected deregulation (Appt's Br. 25). It is interesting to note that had complete deregulation ***20** been established by Congress, ERG would have been stuck with the definite contract price, for there would have been *no* "higher . . . regulated price". [44] Paradoxically, ERG benefited more from the Kansas Act than it would have under full deregulation.

43 Congressional Budget Office, Natural Resources and Commerce Division, *The Natural Gas Compromise*, August 2, 1978, pp. 5-6.

Even if ERG was precognitive enough to foresee and expect the NGPA, then its crystal ball should have also revealed Section 602 and the resultant Kansas Act. "Even if the passage of the [NGPA] could have been foreseen, state inaction could not have been foreseen." [45] In sum, ERG had no reasonable expectation at the time of the contract that any governmental body would establish any price much higher than the contract price.

44 Section 6.7 [8.5] J.S. App. 66a.

C. The Reliance Interest of the Parties "Cuts Both Ways" so That KPL Could Rely on Moderate Prices.

"In some situations the elements of reliance may cut both ways", *Allied Structural Steel*, 438 U.S. at 246, fn. 18. This is such a case. In entering this contract, KPL relied on the law as it was at the time the contract was made. It could have relied on rates set "after agency proceedings, safeguarded by adversary participation and opportunity for judicial review". [46] The purpose of the Contract Clause is to "leave the parties to the law under which they contracted". [47] KPL's reliance interest was abrogated by the ***21** NGPA. [48] Oklahoma and Kansas were merely trying to restore the parties to the *status quo ante*, while protecting the injured reliance interests of purchasers.

45 *Edmiston*, p. 13.

46 *Pennzoil Co. v. Federal Energy Regulatory Com'n*, 645 F.2d 360, 389 (1981).

47 *Blaisdell*, 290 U.S. at 460 (Justice Sutherland, dissenting, quoting William Patterson of New Jersey).

Thus, based on reliance and expectation interests, the state Acts should be upheld. "Laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the Contract Clause, notwithstanding that they technically alter an obligation of a contract." [49]

48 *Edmiston*, p. 12.

ERG had no expectation or reliance interest violated by the Kansas Act. The obligation of contract was only minimally impaired. "Minimal alteration of contractural obligations may end the inquiry at its first stage", *Allied Structural Steel*, 438 U.S. at 245. This Court should end its inquiry here, and base its opinion on the lack of an impaired obligation.

II. THE NGPA WAS AN UNFORSEEN AND UNFORESEEABLE EVENT WHICH ALTERED CONTRACT PROVISIONS TO THE DETRIMENT OF THE PUBLIC WELFARE.

The opinion of this Court in *Blaisdell*, 290 U.S. 398, has an extensive discussion of the "emergency" powers of a state, *e.g.*, 390 U.S. at 425-426; 439-442. The first *Blaisdell* factor is the existence of an emergency, 290 U.S. at 444. Later cases declared this emergency" factor as "subsumed in the overall determination of reasonableness" and not "regarded as essential in every case", ***22** *United States Trust*, 431 U.S. at 22-23, fn. 19. [50] More recent cases have apparently revised the "emergency" factor into testing whether unforeseen events have caused the original contracts to impact on the public in new, adverse ways. [51] The state "must show that it did not know and could not have known the impact of the contract on that state interest at the time that the contract was made", *United States Trust*, 431 U.S. at 32 (Burger, C.J., concurring).

49 *El Paso*, 379 U.S. at 497 (1965).

50 *See also Viex*, 310 U.S. at 39-40; *East New York Savings Bank v. Hahn*, 326 U.S. 230 (1945).

Using this standard, the record before this Court is clear that the NGPA constituted an unforeseen development that altered contracts in a manner adverse to the public interest. Supporters of the Kansas Act called the NGPA a "radical reversal of federal policy" (J.S. App. 74a), and the Kansas Supreme Court concurred. "The NGPA constituted an entirely new and drastically different approach to the pricing of natural gas; it broke with the past, and substituted deregulation for close agency regulation . . ." (J.S. App. 22a). Neither Oklahoma nor Kansas knew or could have known of the revolutionary changes contained in the NGPA when these contracts were made in 1975. These changes do not create the power to alter contracts, but "afford a reason for the exertion of a living power", ***23** *Blaisdell*, 290 U.S. at 426. Thus, utilizing this Court's recent standards, Oklahoma and Kansas had an appropriate situation for the exercise of their powers, and should be sustained in that exercise. [52]

51 Thus in *El Paso v. Simmons*, this Court upheld a Texas law reposing land titles because the discovery of mineral wealth and developing problems connected with land held by speculators were "developments hardly to be expected or foreseen", 379 U.S. at 515 (1965). Conversely, in *United States Trust v. New Jersey*, this Court struck down a law repealing a state covenant because increased general concern regarding environmental protection and energy conservation were "not unknown" at time of covenant and did not cause it to have a "substantially different impact" on the public, 431 U.S. at 32.

III. THE STATE ACTS ADDRESS THE LEGITIMATE END OF DEALING WITH THE BROAD, GENERALIZED ECONOMIC PROBLEMS CREATED BY THE NGPA.

The second *Blaisdell* test was that the legislation was addressed to a "legitimate end", "not for the mere advantage of particular individuals but for the protection of a basic interest of society", 290 U.S. at 445. The *Allied Structural Steel* opinion called for the enactment to deal with a "broad, generalized economic . . . problem", 438 U.S. at 250. The Court traditionally has not looked behind the legislative determination unless a state contract and the states "self interest" is at stake, *United States Trust*, 431 U.S. at 26, or the act "clearly has an extremely narrow focus", *Allied Structural Steel*, 438 U.S. at 248.

ERG is trying to shoehorn this case into resembling the case in *Allied*, where only a pair of employers could possibly be affected by the specific conditions of the Minnesota law. [53] ***24** Here the interest of the public is broad and generalized, as evidenced by the fact that *three* separate sovereign *states* adopted parallel approaches to the NGPA. ERG is trying to make the Kansas Act a one-company law, totally ignoring the fact that KPL had nothing to do with the New Mexico or Oklahoma Acts.

52 Even under ERG's interpretation of the old *Blaisdell* standard, the State Acts could be sustained. The Oklahoma Legislature separately voted for a declaration of emergency, and the Kansas Supreme Court recognized the unforeseen nature of the NGPA. *Blaisdell* gave weight to declarations of emergency both by the Minnesota Legislature and the Minnesota Supreme Court, 290 U.S. at 444.

From the Oklahoma perspective, it is hard to understand anyone questioning the legitimate, broad public purpose of the State Acts. The trial court said the legitimate public purpose could not be questioned (J.S. App. 19a). Chief Judge Theis in *Edmiston* identified two primary purposes of the Acts: to control natural gas prices, especially for public utility consumers, and to regulate windfalls.

The Kansas Act has presumably affected the thirty-seven percent of intrastate gas which had an indefinite price escalator clause in Kansas (J.S. App. 82a) and saved money for the 56% of the purchasers other than KPL (Appt's Br. 31). The Kansas Act has saved Kansas consumers over $128 million dollars (KPL draft brief, p. 36) with equal effect through the Kansas economy. By any standard, $128 million dollars is more than a “modicum”. Saving that many millions clearly constitutes a legitimate end and a broad economic purpose. [54]

53 The Act in *Allied* applied only to employers who: (1) had 100 or more employees; (2) at least one of whom worked in Minnesota; (3) which had established a voluntary pension plan; (4) had terminated his pension plan or closed his Minnesota office; (5) after April 10, 1974; and (6) before January 1, 1975. (438 U.S. at 248-249).

State legislatures may legitimately control intrastate gas prices, *Cities Service Gas Co. v. Peerless Oil and Gas* ***25** *Co.*, 340 U.S. 179 (1950). The prevention of windfalls is also a legitimate public purpose, *El Paso*, 379 U.S. at 515 (1965). [55] Congress explicitly recognized the legitimacy of state action in controlling indefinite price escalator clauses by the passage of Section 602 of the NGPA. Whatever else that section means, it clearly indicates that legislative action in this area is a legitimate action by a state.

54 Oklahoma is arguing the Kansas numbers because they are significant in their own right. They may unfairly seem less significant compared with Oklahoma's 65% of gas covered by indefinite price escalator clauses, enormous reliance on intrastate gas, and nearly a billion dollars in saving for consumers. Virtually every Oklahoman is affected by the Oklahoma Act. The smaller proportional effect in Kansas is still much larger than the miniscule effect in *Allied Structural Steel*.

Oklahoma in this brief gives the question of legitimate public purpose a summary disposition only because the question seems so clear to us. Oklahoma explicitly joins in the more lengthy discussions of this issue contained in KPL's brief and the brief of *amicus* Oklahoma Natural Gas, *et al*. The conclusion to all the argument is clear: the State Acts are directed toward a legitimate state end and broad, generalized public purpose.

IV. THE STATE ACTS ARE IN AN AREA ALREADY SUBJECT TO PRIOR STATE REGULATION AT THE TIME OF THE CONTRACT.

ERG virtually concedes that the Kansas Act was in an area already subject to state regulation but relegated that fact to a footnote as “irrelevant” (Appt's Br. 29, fn. 40). Oklahoma believes the establishment of the fact that this was an area subject to regulation at the time of the contract is relevant both to demonstrate that the contract was not significantly impaired, and to show the legitimacy of this particular exercise of the police power.

The test was stated in *Allied Structural Steel:* whether the act operated “in an area already subject to state regulation ***26** at the time the company's contractural obligations were originally undertaken” 438 U.S. at 250, citing *Veix v. Sixth Ward Assn.*,

310 U.S. 32. In *Viex*, this Court stated the rule: "When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic", 310 U.S. at 38.

When ERG entered the natural gas field, it should have known it was entering an intensely regulated industry. In Oklahoma, natural gas prices have been subject to Corporation Commission control since 1913, 52 O.S. 1981, §§ 52, 53. Clear evidence of Kansas' known ability to regulate in this area is provided by the contracts themselves, which speak of a "Kansas regulatory or governmental authority" setting prices (J.S. App. 66a) and "present and future state law" (J.S. App. 69a-70a), regulating the conduct of the parties. ERG "purchased into" an area it knew was regulated, and now complains when it is in fact regulated. This Court should recognize that prior state regulation in this area gave ERG ample warning that the state would not sit quietly when the public interest was adversely affected.

V. THE STATE ACTS HAVE REASONABLE CONDITIONS AND ARE OF A CHARACTER APPROPRIATE TO THEIR PUBLIC PURPOSE, FOR THEY ARE CAREFULLY PATTERNED AFTER THE NGPA.

This Court summarized the relevant rule for private contracts in *United States Trust*, 431 U.S. at 22-23:

"Legislation adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption. As is customary in reviewing ***27** economic and social regulation, however, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." (citations omitted)

ERG grants the states no deference in their legislative judgment, but attempts to list what it sees as viable alternatives to the considered decisions of three legislatures. If we recall that the objectives of the legislation are to protect natural gas purchasers from unanticipated price hikes and prevent windfall profits to producers, it is easy to dispose of the proffered "alternatives".

ERG suggests that the states could have refused to allow utilities to pass through the higher cost of gas (Appt's Br. 37). This action might protect consumers in the short run, but would not have adjusted the windfall for producers. Furthermore, it would have had the effect of denying the utilities compensation for their expenses, which could lead to a claim of deprivation of property without due process, as guaranteed by the Fourteenth Amendment, *Bluefield Water Works v. Public Service Com'n.*, 262 U.S. 679 (1923); *FPC v. Hope Natural Gas*, 320 U.S. 591 (1944). In addition, in the long run it might cost ratepayers more, for few utilities could stay out of bankruptcy court if their stockholders were to be forced to swallow a proportionate share of a billion dollar outflow.

ERG's second alternative is to shift the expense of the higher costs to industrial customers through "incremental pricing". This alternative fails both primary objectives of protecting *all* ratepayers from rate jumps, and once again does not alter the windfall income of producers.

***28** ERG complains that the Acts allow for voluntary renegotiation of contracts (Appt's Br. 39-40). Oklahoma wonders if ERG would truly have been happier with an act that *prohibited* renegotiation. Under such a provision, *both* parties might be stuck in an agreement that each wanted to change, but be prohibited by law from doing so. Under such a scenario, we might have some *serious* constitutional challenges to such a law.

ERG asserts that the Acts lack the temporary nature found important in *Blaisdell* (Appt's Br. 39). The Acts are conceded to have a termination date which coincides with the termination of the NGPA. Claims that the *impairment* is permanent are necessarily based on the conclusion that there is significant impairment. Since ERG had no reason when it made the contracts to expect a windfall, it loses nothing when the windfall does not come.

Finally, we come to the question of whether indefinite price escalator clauses are against public policy. ERG recites that Kansas has not restricted them; KPL has agreed to them; and the NGPA was meant to trigger them. Unnoted by KPL is the fact that the Acts continue to give such clauses an active role. They still work; just not to the explosive extent that they might have. The Legislatures are directed to use means "of a character appropriate to the public purpose", *United States Trust*, 431 U.S. at 21. This Court has recognized that indefinite price escalators can legitimately be found to be against public policy, *Permian*

Basin Area Rate Cases, 390 U.S. 747, 782 (1968). Since the state legitimately could prohibit their entire existence, they are very suitable material for lesser regulation in the public good. Through the Acts, the indefinite price escalator ***29** clauses are tamed to gradually introduce energy price increases into the state economy. This Court has recognized that a gradual approach may also be a factor in assessing the reasonableness of a legislative act, *Allied Structural Steel*, 383 U.S. at 247.

The Oklahoma Legislature carefully tailored the Oklahoma Act to conform to the situation before it and the precedents of this Court. The result was a reasoned and careful response to the situation, with constant legislative monitoring of the effects and results. After equally careful consideration, this Court should affirm the efforts of the Oklahoma and Kansas legislatures.

CONCLUSION

The ultimate question contained in this case for the Court is: What is the nature of the Contract Clause nearly two centuries after it was drafted? We know it is not a "mathematical formula", *Blaisdell*, 290 U.S. at 428. We know it is not a "dead letter", *Allied Structural Steel*, 438 U.S. at 241. We know it has not been "balanced away", *United States Trust*, 431 U.S. at 29, but the police power can not be bargained around, *Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908). What, then, *does* it mean?

The Contract Clause is a process, a series of tests for suspected offending state legislation. First, we test to see if there is any impairment at all, looking to the language of the contract, the reasonable expectation of the parties, and the language of the act. If there is no impairment, then our examination is at an end.

***30** If there appears to be some impairment, we evaluate the amount of impairment. If it is very slight, once again we end the examination. If the impairment is more than slight, then we must look to the reason why the act was passed and whether the act is unreasonable in light of those reasons.

It is a valid reason if the act is in response to an unforeseen occurrence which has caused private contracts to be hurtful to the public good. It is not a valid reason if the act is for the benefit of the few, rather than the many; if it is in the state's selfish interest; or if it is designed to destroy the contractural obligation. If the protection of the act does not serve a legitimate interest, then the means to effectuate it are automatically unreasonable.

If the protection of the act serves a legitimate interest then we must examine the means by which the act seeks to afford such protection. If the act is itself an unforseen calamity; if it is instant burden, rather than gradual; if it is perpetual, then it may be an unreasonable response on the legislature's part.

If we examine the Oklahoma and Kansas Acts by these standards, they do not violate the Contract Clause. The Acts do not impinge upon the reasonable expectation of the parties, or if they do, it is slightly. The protection of the act is not of a forbidden type, but rather is for the benefit of the majority of Kansans and Oklahomans. The protection is implemented in an area where the state has acted before. The methods are gradual, and the Acts are temporary. The Acts are careful responses to difficult and complex situations, and should therefore be approved by this Court.

***31** Respectfully submitted,

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55 “This Court's decisions have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change.”

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