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NOTES AND COMMENTS

LEGISLATIVE IMPAIRMENT OF NATURAL GAS CONTRACTS: *ENERGY RESERVES GROUP, INC. v. KANSAS POWER & LIGHT CO.*

I. INTRODUCTION

The recent United States Supreme Court decision in *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*[1] involved an action filed by a natural gas producer, Energy Reserves Group (ERG), to enforce the contractual provisions of its long-term agreements with Kansas Power & Light (KPL).[2] The conflict centered around indefinite price escalator clauses[3] in those agreements that allowed the contract price for natural gas to rise in response to certain outside factors.[4] As a result of the inclusion of these escalator clauses in the contracts, the passage of the Natural Gas Policy Act of 1978[5] created the potential of substantially increasing the price of the natural gas sold by ERG.[6] The Kansas Natural Gas Price Protection Act[7] (Kansas Act) was passed, in part, to limit such increases.[8] ERG contended that the Kansas Act was a violation of the contract clause of the United States Constitution.[9] Despite the Constitution's proscription of state legislation that impairs contractual obligations, the Supreme Court upheld the constitutionality

1. 103 S. Ct. 697 (1983).
2. *Id.* at 703.
3. " 'Indefinite price escalator clause' means any provision of a gas purchase contract which provides for the establishment or adjustment of the price of natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products." KAN. STAT. ANN. § 55-1402(c) (1983).
4. 103 S. Ct. at 701; *see infra* notes 66-69 and accompanying text.
5. 15 U.S.C. §§ 3301-3432 (1982).
6. The NGPA modified federal price controls under the Natural Gas Act of 1938, 15 U.S.C. §§ 717c-717d (1982), with upward-adjustable ceilings that respond monthly to various economic factors. *See id.* §§ 3311-3319. Additionally, the NGPA extended federal regulation to the intrastate gas market. *Id.* § 3315.
7. KAN. STAT. ANN. §§ 55-1401 to -1415 (1983).
8. Energy Reserves Group, Inc. v. Kansas Power & Light Co., 230 Kan. 176, —, 630 P.2d 1142, 1152 (1981).
9. U.S. CONST. art. I, § 10, cl. 1.

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of the Kansas Act.[10]

Energy Reserves is important for several reasons. Recent Supreme Court decisions had cast a shroud of confusion over the contract clause that left its application uncertain.[11] The *Energy Reserves* decision helps clear up this imbroglio and establishes an interpretation that allows states, under appropriate circumstances, to alter contractual agreements that touch areas of general public concern.[12] *Energy Reserves* also proved useful because it resolved similar litigation with even greater ramifications pending in an Oklahoma federal court.[13] The *Energy Reserves* decision rendered the Oklahoma case moot and shifted approximately $1 billion from the pockets of producers to consumers and, to a lesser extent, certain public utilities.[14] Moreover, the decision represents a reaffirmation of the post-1937 reluctance of the Court to overturn state economic legislation on a contract clause basis,[15] an approach that may be essential in a time of crisis in the energy industry.

The first purpose of this Note is to analyze previous contract clause cases and the *Energy Reserves* decision to determine current contract clause application. Secondly, this Note will focus on the effect of the decision in Oklahoma. Finally, the Note will explore the significance of the *Energy Reserves* decision in light of the nation's continuing natural gas glut inasmuch as the decision leaves open the possibility that states could take advantage of the liberal interpretation of the contract clause to deal with current problems associated with the oversupply.

II. CONTRACT CLAUSE ANALYSIS

A. *Law Prior to* Energy Reserves

The contract clause declares, "No State shall . . . make any . . .

10. *Energy Reserves*, 103 S. Ct. at 710.

11. *See infra* notes 40-51 and accompanying text.

12. *See infra* notes 86-104 and accompanying text.

13. Energy Consumers & Producers Ass'n v. Baker, Nos. 79-320-D; 79-823-D (W.D. Okla. filed Mar. 20, 1979) (withdrawn June 7, 1983). The second docket number refers to a suit filed by the Oklahoma Independent Petroleum Association and Amerada Hess Corporation against the same defendants. The suits were consolidated and the case was fully briefed, but the trial was postponed pending a decision in *Energy Reserves*. When that decision was reached, plaintiffs withdrew their complaint. *See infra* notes 128-29 and accompanying text.

14. *See infra* notes 121-34 and accompanying text.

15. *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 8-7 (1978).

Law impairing the Obligation of Contracts."[16] A strict interpretation of this clause was frequently used in the early years of the United States as a constitutional check on state legislation.[17] Included within the Court's interpretation of the contract clause was the concept that when a party enters a contract, that contract incorporates the positive state law in existence at that time.[18] In keeping with this principle, early Court opinions concluded that the state's police power—the right to protect public health and morals[19]—is a part of the state's sovereign authority and accordingly must be incorporated into all contracts.[20] Consequently, parties cannot make a contract that is contrary to state law and rely upon the contract clause to invalidate that law.

Modern interpretation of the contract clause began in 1934 when the Supreme Court handed down its decision in *Home Building & Loan Association v. Blaisdell*.[21] This decision expanded the concept of police power to include economic concerns as justification for the state's exercise of its police power "to safeguard the vital interests of its people."[22]

16. U.S. CONST. art. I, § 10, cl. 1.

17. *See, e.g.*, Fletcher v. Peck, 10 U.S. (6 Cranch) 87, 136 (1810) (The states are part of the union which "has a constitution the supremacy of which all acknowledge, and which imposes limits to the legislatures of the several States, which none claim a right to pass."). *See generally* J. NOWAK, R. ROTUNDA & J. YOUNG, HANDBOOK ON CONSTITUTIONAL LAW 419-24 (1978) (thorough discussion of the contract clause during the Marshall and Taney years).

18. Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 352 (1827). Justice Holmes later stated that, "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them." Hudson Cty. Water Co. v. McCarter, 209 U.S. 349, 357 (1908); *see* L. TRIBE, *supra* note 15, at § 9-5.

19. Stone v. Mississippi, 101 U.S. 814, 818 (1880).

20. For the development of this interpretation, *see, e.g.*, West River Bridge Co. v. Dix, 47 U.S. (6 How.) 507, 532-36 (1848) (a state has certain powers, e.g. eminent domain, that it cannot contract away); Fertilizing Co. v. Hyde Park, 97 U.S. 659, 670 (1878) (ordinance prohibiting fertilizer company from operating within city upheld as protecting public health despite city charter granting such power); Stone v. Mississippi, 101 U.S. 814, 819 (1880) (state statute prohibiting sale of lottery tickets upheld as protecting public morals despite previous 25-year charter granted by legislature to lottery company); Manigault v. Springs, 199 U.S. 473, 481-83 (1905) (extended police power to contracts between private individuals when state legislatures enact laws to reclaim swampland and erect dams for the public good).

21. 290 U.S. 398 (1934). The State of Minnesota passed a statute during the depression that extended the time period under which a defaulting mortgagor could redeem his property after foreclosure. *Id.* at 416-18. Home Building & Loan had purchased Blaisdell's property at a foreclosure sale when the contractual redemption period was one year. The Minnesota statute extended the redemption period, and, as a result, Blaisdell was able to redeem his property. Home Building & Loan challenged the statute alleging that it impaired its contract. *Id.* at 418-20. The Supreme Court upheld the statute. *Id.* at 448.

22. *Id.* at 434, 437; *see also* Note, *Revival of the Contract Clause:* Allied Structural Steel Co. v. Spannaus *and* United States Trust Co. v. New Jersey, 65 VA. L. REV. 377, 382-83 (1979) (points to the importance of *Blaisdell* in adding economic concerns to the state's police power). The *Blaisdell* Court stated, "Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order." 290 U.S. at 435.

Even so, *Blaisdell* recognized that the state's power to impair contracts in the vital interests of its people is not absolute. The Supreme Court examined those significant factors that justify a state's use of its police power and developed an analytic approach for determining those circumstances in which contractual impairment by a state is justified.[23] Basic to the *Blaisdell* approach is the presence of an emergency that justifies invoking the state's police power.[24] Additionally, any attendant contractual impairment[25] must serve a legitimate end, and the means selected to accomplish that end must be both reasonable and appropriate.[26]

The contract clause almost turned into a historical relic in the years that followed *Blaisdell*.[27] Subsequent relaxation of the emergency requirement[28] and a general trend toward judicial deference to

23. 290 U.S. at 444-47. The first factor the Court considered in its analysis was the existence of an emergency "which furnished a proper occasion for the exercise of the reserved power of the State to protect the vital interests of the community." *Id.* at 444. Second, the Court noted that the legislation must be "addressed to a legitimate end, that is, the legislation was not for the mere advantage of particular individuals but for the protection of a basic interest of society." *Id.* at 445. Third, "the relief afforded and justified by the emergency . . . could only be of a character appropriate to that emergency and could be granted only upon reasonable conditions." *Id.* Finally, the legislation must be "temporary in operation." *Id.* at 447.

The Court found that an emergency existed because the economic turmoil of the depression threatened many people with the loss of their homes unless some action was taken. *Id.* at 444-45. The Court also found the Minnesota statute granting a mortgagor a reasonable extension beyond the date stipulated in his mortgage contract for redemption was a reasonable and appropriate means of preventing the threatened "loss of homes and lands which furnish those in possession the necessary shelter and means of subsistence." *Id.* at 445. Finally, the statute was temporary since it was "limited to the exigency which called it forth" and in any event "could not validly outlast the emergency or be so extended as virtually to destroy the contracts." *Id.* at 447. The combination of these factors led the Court to find that the contract clause had not been violated by the Minnesota statute. *Id.*

24. *Id.* at 444.

25. It is important to note that the impairment allowed in *Blaisdell* merely altered the remedies of the bank; it did not completely eliminate them. *Id.* at 445-47. Shortly after *Blaisdell*, the Court held that a total elimination of rights or remedies would not withstand a contract clause attack. *See* W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 62 (1935); W.B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934).

26. 290 U.S. at 445.

27. Actually, its decline began as early as the late 19th century when the due process clause began to assume the contract clause role as a check on state power. *See* L. TRIBE, *supra* note 15, at § 8-2. The subsuming character of the due process clause during the substantive due process era was attributed to its broader coverage of economic rights than the contract clause. *See, e.g.*, Allgeyer v. Louisiana, 165 U.S. 578 (1897); Chicago, M. & St. P. Ry. v. Minnesota, 134 U.S. 418 (1890); *see also* Note, *State Adjustment of Private Employer's Obligations Under Pension Plan Violates Contract Clause*, 9 SETON HALL 784, 788-92 (1978) (contrasts the rise in prominence of the due process clause with the decline in importance of the contract clause); *cf. The Supreme Court, 1976 Term*, 91 HARV. L. REV. 72, 83-84 (1977) (points to the takings provision of the fifth amendment as having assumed part of the contract clause role).

28. *See* Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32, 39-40 (1940) (financial condition of banks was tenuous enough to justify extending duration of statute affecting withdrawal

state legislatures[29] led to the near demise of the clause as a vehicle for overturning state legislation.[30] Despite its moribund state, however, the contract clause never completely succumbed. Two recent decisions, *United States Trust Co. v. New Jersey*[31] and *Allied Structural Steel Co. v. Spannaus*,[32] helped restore some of its former vitality by striking down state legislation for the first time in nearly forty years on a contract clause rationale.[33] Unfortunately, these decisions also created such confusion as to leave contract clause interpretation unsettled.[34]

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rights beyond the emergency created by the depression); East N.Y. Sav. Bank v. Hahn, 326 U.S. 230, 234-35 (1945) (prevention of future emergencies is legitimate reason for exercising state's police power and impairing contractual obligations); United States Trust Co. v. New Jersey, 431 U.S. 1, 22 n.19 (1977) ("Undoubtedly the existence of an emergency and the limited duration of a relief measure are factors to be assessed in determining the reasonableness of an impairment, but they cannot be regarded as essential in every case."); Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 249 n.24 (1978) ("This is not to suggest that only an emergency of great magnitude can constitutionally justify a state law impairing the obligations of contracts.").

29. *See, e.g.*, Ferguson v. Skrupa, 372 U.S. 726, 730 (1963) ("We have returned to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws."); *East N.Y. Bank*, 326 U.S. at 233 ("Once we are in this domain of the reserve power of a State we must respect the 'wide discretion on the part of the legislature in determining what is and what is not necessary.' "); Sproles v. Binford, 286 U.S. 374, 388 (1932) (Court will not "subject the State to an intolerable supervision hostile to the basic principles of our Government."). *See generally* L. TRIBE, *supra* note 15, at § 8-7 (discusses demise of socioeconomic philosophy of Lochner v. New York, 198 U.S. 45 (1905), and the almost complete judicial abdication to legislatures).

30. In fact, from 1938 to 1977 the Supreme Court only struck down two statutes as being violative of the contract clause. *See* Wood v. Lovett, 313 U.S. 362 (1941); Indiana *ex rel.* Anderson v. Brand, 303 U.S. 95 (1938); *see also* Note, *A Process-Oriented Approach to the Contract Clause*, 89 YALE L.J. 1623, 1623 n.7 (1980) (notes that neither case was a typical case of contract impairment).

The contract clause's death knell appeared to have been sounded in 1964 when the Court handed down its decision in City of El Paso v. Simmons, 379 U.S. 497 (1965). *Simmons* involved the sale of land by the State of Texas. The sales contracts called for forfeiture of the land in the event the purchaser defaulted; however, the purchaser could reinstate his claim by paying off the delinquent payments plus interest. Even though this contractual redemption right was perpetual, the State passed a five-year statute of limitations effectively altering the provision of the contracts. *Id.* at 498-501. The Court upheld the statute on the basis that the State's desire to perfect land titles and avoid litigation was sufficient to override any limitations the contract clause might present. *Id.* at 511-12; *see also* P. BREST & S. LEVINSON, PROCESSES OF CONSTITUTIONAL DECISIONMAKING 311 (2d ed. 1983) (contract clause application from 1934-82).

Justice Black's dissent sounded more like an obituary. He chastized the Court for balancing "away the plain guarantee" of the clause, 379 U.S. at 517, lamenting that the Court's interpretation of *Blaisdell* had "practically read the Contract Clause out of the Constitution." *Id.* at 523.

31. 431 U.S. 1 (1977).

32. 438 U.S. 234 (1978).

33. *See The Supreme Court, 1977 Term*, 92 HARV. L. REV. 57, 86-87 (1978); Note, *supra* note 22, at 377.

34. One commentator noted that, "For two cases decided so closely together by a Court whose composition had not changed, the decisions in *United States Trust* and *Spannaus* contain a number of inconsistencies that make it difficult to discern the Court's present attitude toward contract clause issues." Note, *supra* note 22, at 395.

Blaisdell had established a type of means-end standard[35] that required the use of reasonable and appropriate means to bring about a legitimate end.[36] Subsequent cases indicated a willingness to leave the determination of reasonableness to the state legislature.[37] However, the *United States Trust* Court broke with tradition by refusing to defer the selection of the means to the legislature when the state is a contracting party.[38] The Court reasoned that if a state has an interest in the contract, its actions should not be entitled to presumptive legitimacy.[39]

In addition to according less deference to the legislature, the *United States Trust* Court modified the *Blaisdell* standard by declaring that "an impairment may be constitutional if it is *reasonable* and *necessary* to serve an *important* public purpose."[40] This rather curious com-

35. *See* Note, *The Contract Clause: The Use of a Strict Standard of Review for State Legislation that Impairs Private Contracts*—Allied Structural Steel Co. v. Spannaus, 28 DE PAUL L. REV. 503, 513 (1979).

36. *See supra* text accompanying note 26.

37. *See supra* note 27.

38. 431 U.S. at 26. The States of New York and New Jersey established the Port Authority in 1921 to coordinate the affairs of the port of New York. *Id.* at 4. Bonds were sold to private investors to help finance the operation of the Port Authority and were to be retired through bridge and tunnel toll revenues. *Id.* at 4-5. There was concern among bondholders that some of the toll income would be used to subsidize a financially troubled commuter train that was taken over by the Authority in 1960. *Id.* at 9. Because of this concern, the States passed the "1962 Statutory Covenant" that required that no money designated for bond retirement be used to finance railroad deficits. *Id.* at 9-10. However, the energy shortages of the 1970's caused great concern for public transit. In response, the two States passed 1974 statutes that repealed the 1962 covenant, allowing the use of toll revenues to subsidize mass transit. *Id.* at 12-14. The statutory repeal was challenged as a violation of the contract clause, and the Supreme Court agreed. *Id.* at 32. *See generally* McTamaney, *United States Trust Company of New York v. New Jersey—The Contract Clause in a Complex Society*, 46 FORDHAM L. REV. 1 (1977) (discussion of entire litigation by a counsel for plaintiff).

39. 431 U.S. at 25-26. The Court applied a two-part test for assessing the means selected by a state when the state is one of the contracting parties. The contract that is impaired by the legislation may be invalid from its inception under the reserved-powers doctrine if it involves the state's surrendering an essential attribute of its sovereignty. *Id.* at 23-25. If the contract does not involve such a surrender, the legislation that impairs the contractual obligations must be reasonable and necessary, as viewed by the judiciary, before the impairment will be allowed. *Id.* at 25-26; *see* McTamaney, *supra* note 38, at 49-51; Note, *supra* note 22, at 390-91.

In *United States Trust*, the Court found that the contractual obligations of New York and New Jersey were valid because financial obligations of a state do not fall within the realm of police powers that cannot be contracted away. 431 U.S. at 24-25. Proceeding to the second part of the test, the Court nevertheless found that the repeal of the statutory covenant with the bondholders was neither reasonable nor necessary since the States could have achieved the goal of improving mass transit without destroying the security of the bonds. *Id.* at 29-32.

The Court feared a state might find it expedient to finance public projects by simply abrogating some of its financial obligations, instead of raising taxes to finance such projects. *Id.* at 26; *see* L. TRIBE, *supra* note 15, at 472-73. *But see* Hurst, *Municipal Bonds and the Contract Clause: Looking Beyond* United States Trust Company v. New Jersey, 5 HASTINGS CONST. L.Q. 25, 43 (1978) (argues that the state interest is really that of the public and that state's contracts should be entitled to the same presumption as private contracts).

40. 431 U.S. at 25 (emphasis added).

bination of words appears to forge a partnership between a relaxed standard of review and a strict one.[41] However, the Court apparently perceives no such result since it interprets the reasonableness requirement as a matter of the foreseeability of the current circumstances. If the interests sought to be served by the new legislation were foreseeable when the original legislation that sanctioned the contracts was adopted, then the impairment of those contracts through new legislation is not a reasonable means of serving the current purpose.[42] The Court differentiates reasonableness from necessity by reasoning that the impairing legislation is not necessary if either a less drastic modification or an alternative means would accomplish the same goal.[43] The confusion surrounding the interpretation of this revised standard is joined by uncertainty as to its long-term precedential value, since the case was decided by a four-three vote.[44]

Allied Structural Steel is of greater relevance to *Energy Reserves* than *United States Trust* because it deals with a state's attempt to impair obligations in a contract between private parties.[45] Unfortunately, this decision only further confuses the situation. The Court attempts to

41. In a lengthy footnote in his dissent, Justice Brennan points out the contradiction created by this wedding of terms:

> Reasonableness generally has signified the most relaxed regime of judicial inquiry. . . . Contrariwise, the element of necessity traditionally has played a key role in the most penetrating mode of constitutional review. . . . The Court's new test, therefore, represents a most unusual hybrid which manages to merge the two polar extremes of judicial intervention . . . . [O]ne would have fairly thought that as a matter of common sense as well as doctrine, state policies that are "necessary to serve an important public purpose" . . . *a fortiori* would be "reasonable."

431 U.S. at 54-55 n.17 (Brennan, J., dissenting).

The substitution of the term "important" for *Blaisdell*'s "legitimate" in describing the purpose of the challenged legislation raises the question whether the Court was attempting to apply the "middle-tier" approach to judicial scrutiny adopted for certain classifications of equal protection cases during the early 1970's. *See* L. TRIBE, *supra* note 15, at § 16-30; *The Supreme Court, 1976 Term, supra* note 27, at 86-87.

42. 431 U.S. at 29.

43. *Id.* at 31.

44. Justice Blackmun delivered the opinion of the Court, joined by Justices Rehnquist and Stevens. Justice Burger filed a concurring opinion, providing the fourth vote in the decision. Justices Brennan, White and Marshall dissented. Justices Stewart and Powell took no part in the decision.

45. 438 U.S. 234, 236-41 (1978). Allied Structural Steel, an Illinois corporation, established a pension plan which included its Minnesota employees while retaining its rights to amend the plan in whole or in part. *Id.* at 236-37. Allied had been planning to close its Minnesota office and discontinue the pension program as to the Minnesota employees. *Id.* at 247. Before the corporation could do so, the State of Minnesota enacted a law that subjected such pension plans to a pension funding charge if the plan was terminated or the company's Minnesota offices were closed. The purpose of the statute was to assure full pensions to all employees who had worked at least 10 years. *Id.* at 238-39. Allied challenged the statute as being violative of the contract clause. *Id.* at 239-40. The Supreme Court agreed. *Id.* at 251.

establish a three-part standard against which statutes impairing contracts between private parties can be measured to determine their constitutional validity. According to the *Allied Structural Steel* Court, "[T]he first inquiry must be whether the state law has, in fact, operated as a substantial impairment of a contractual relationship."[46] The second element of the standard requires an assessment by the court of the reasonableness and necessity of the means selected by the state.[47] This is perplexing because this requirement is an integral part of the standard applied in *United States Trust* to evaluate impairing legislation when the state itself is a party to the contract.[48] Understandably, commentators are confused since it appears that the Court has fashioned a strict standard of review for legislation impairing contracts between private parties.[49] Some even view this standard as being stricter than that applied when the state is a contracting party.[50] This confusion is unfortunate because the *Allied Structural Steel* decision actually turns upon the statute's failure to meet the third part of the test: the require-

46. *Id.* at 244. The severity of the impairment is measured by the parties' reliance upon the contractual rights and obligations. *Id.* at 245. If one of the parties materially changes his position in reliance upon a particular provision, the impairment is probably substantial. According to this test, if no substantial impairment exists, the investigation is at an end; the legislation will be upheld. *Id.*

Applying the facts in *Allied* to this element of the standard, the Supreme Court found that a substantial impairment existed because Allied relied heavily upon its right to modify or cancel the plan. Action taken in reliance on this right forced Allied to pay an additional $185,000 pursuant to the statute in order to vest the rights of a number of employees, even though these employees had no such expectation. *Id.* at 244-47. For a critical review of the *Allied* Court's application of this element, see Note, *supra* 35, at 512-15.

47. 438 U.S. at 244. "The presumption favoring 'legislative judgment as to the necessity and reasonableness of a particular measure' . . . simply cannot stand in this case." *Id.* at 247 (quoting *United States Trust*, 431 U.S. at 23); *see also* Note, *supra* note 30, at 1624-25 n.12 (laments the same inconsistency regarding scrutiny of private contracts and decries the absence of any standard for assessing the means except an "unstructural factor-based balancing approach").

48. "[C]omplete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." *United States Trust*, 431 U.S. at 26; *see supra* note 40 and accompanying text.

49. One observer stated, "It appears that the *Allied* majority has extended the stringent standard of review established in *United States Trust* to private contracts." Note, *supra* note 35, at 518; *see also* Sovern, Allied Structural Steel v. Spannaus: *Added Obligations, The Contract Clause, and Due Process*, 16 COLUM. J.L. & SOC. PROBS. 119, 128 (1980) (sees a divergence of standards of review with the due process clause becoming more relaxed and the contract clause becoming more strict); *The Supreme Court, 1977 Term, supra* note 33, at 95-96 (views the Court as having adopted a stricter balancing test between the end and the means).

50. One observer concluded that the old *Blaisdell* test was being fully restored because the Court, in striking down the statute, pointed out that the law was not a temporary measure aimed at dealing with an emergency. Note, *supra* note 22, at 393-94. This conclusion is not supportable in light of a footnote that accompanied the majority opinion, stating, "This is not to suggest that only an emergency of great magnitude can constitutionally justify a state law impairing the obligations of contracts." 438 U.S. at 249 n.24.

ment that the statute address a legitimate end.[51]

United States Trust and *Allied Structural Steel* breathed new life into the contract clause. The uncertainty regarding the applicability of the modified contract clause standard awaited resolution in a subsequent contract clause challenge.

B. *The* Energy Reserves *Decision*

1. Background Information

The 1970's were a time of great instability in the oil and natural gas markets. American support of Israel led the Arab-dominated Organization of Petroleum Exporting Countries (OPEC) to embargo oil sales to the United States in 1973[52] and later to significantly increase oil export prices.[53] OPEC's actions led to rapid price increases for all energy sources, reflecting the fact that oil prices act as a barometer for the pricing of other energy sources.[54] Natural gas prices in the unregulated intrastate market almost doubled from 1973 to 1975.[55] Prices in the interstate market, however, did not rise as quickly because of heavy regulation.[56] This led to disparities between interstate and intrastate gas prices and a shortfall in the interstate market.[57]

In an effort to introduce stability into the energy markets, President Carter recommended a comprehensive energy plan to Congress that included a natural gas price control proposal.[58] After considerable debate, a joint conference committee of both houses proposed the bill that was later enacted as the Natural Gas Policy Act (NGPA).[59] The

51. 438 U.S. at 247-50. Since only a handful of employees was affected, *id.* at 248-50, the Court stated that, "[T]here is no showing . . . that this severe disruption of contractual expectations was necessary to meet an important general social problem." *Id.* at 247.

If the Court had said nothing more, there would have been no confusion regarding the decision and its basis, but it continued by saying, "The presumption favoring 'legislative judgment as to the necessity and reasonableness of a particular measure,' simply cannot stand in this case." *Id.* (quoting *United States Trust*, 431 U.S. at 23). This statement creates the presumption that the means selected by the legislature to deal with a general social problem will be closely scrutinized by the Court.

52. Comment, *Cartel Pricing in the International Energy Market: OPEC in Perspective*, 54 OR. L. REV. 643, 653 (1975).

53. *Id.* at 654.

54. STAFF OF SUBCOMM. ON ENERGY, JOINT ECONOMIC COMM. OF CONG., 95TH CONG., 1ST SESS., THE ECONOMICS OF THE NATURAL GAS CONTROVERSY 59 (Comm. Print 1977).

55. *Id.*

56. *Id.* at 17.

57. *Id.*

58. *Energy: Will Americans Pay the Price?*, U.S. NEWS & WORLD REP., May 2, 1977, at 13, 15. This plan was announced on April 20, 1977.

59. 15 U.S.C. §§ 3301-3432 (1982).

NGPA was signed into law on November 9, 1978, and took effect on December 1 of that year.

In addition to extending federal price regulation to intrastate gas markets, the NGPA sets different ceilings for different types of gas. Section 102 sets a gradually increasing price ceiling for newly discovered or produced natural gas.[60] Section 105(b)(1) establishes the maximum lawful price for old intrastate gas as "the lower of (A) the price under the terms of the existing contract . . . or (B) the maximum lawful price . . . under section 102."[61] Section 109 is a catchall category for gas not covered by other sections of the NGPA.[62] Congressional reports clearly indicate that the NGPA was not meant to preempt the power of the states to enforce lower prices for the sale of natural gas within the state.[63] Accordingly, section 602(a) permits a 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 . . . this chapter."[64]

2. The *Energy Reserves* Facts

KPL executed two contracts with ERG's predecessor-in-interest on September 27, 1975, for the purchase of natural gas at the wellhead.[65] The contracts set a purchase price subject to a governmental price escalator clause[66] and a price redetermination clause.[67] These

60. *Id.* § 3312. The price under § 102 for deliveries during the month of December 1978 was $2.078 per million British thermal units (MMBtus). *Energy Reserves*, 103 S. Ct. at 702.

61. 15 U.S.C. § 3315 (1982). The gas involved in the ERG litigation was classified as old intrastate gas governed by § 105. *Energy Reserves*, 103 S. Ct. at 702. "Old intrastate gas" describes gas that was not committed to interstate commerce on November 8, 1978. *Id.*

62. 15 U.S.C. § 3319 (1982). The monthly price under § 102 is always higher than the price under § 109. Conservation of Power, Water Resources, 18 C.F.R. § 271.101 (1982). The price for deliveries in December 1978 under § 109 was $1.63 per MMBtus. *Energy Reserves*, 103 S. Ct. at 702. This is $.44 less than the price allowed under § 102 for the same time period. *See supra* note 60.

63. 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 . . . this Act. This authority extends to the operation of any indefinite price escalator clause.

103 S. Ct. at 708 (quoting S. CONF. REP. No. 95-1126, 124-25 (1978); H.R. CONF. REP. No. 95-1752, 124-25 (1978)).

64. 15 U.S.C. § 3432(a) (1982).

65. 103 S. Ct. at 700. The original contract was actually between KPL and the Clinton Oil Co.; ERG assumed Clinton's interest. *Id.* The two contracts involved were to remain in effect for the life of the field or the life of the processing plants associated with the field. *Id.* at 701.

66. The governmental price escalator clauses of the contracts read as follows:

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

two clauses, known as "indefinite escalator clauses,"[68] allowed the contract price of gas to rise in response to the occurrence of specified events outside the contract.[69] The exercise of either escalator clause by ERG required KPL to obtain permission from the Kansas Corporation Commission (Commission) to pass the increase through to consumers.[70] The contracts also provided that if the Commission denied the pass-through and KPL elected not to pay the increase, ERG could terminate the contracts on written notice.[71]

In response to the 1978 federal enactment of the NGPA, the Kansas legislature passed the Kansas Natural Gas Price Protection Act (Kansas Act) to impose price controls on the intrastate gas market.[72] The Kansas Act applies only to contracts for the sale of intrastate gas entered into before April 20, 1977.[73] The September 27, 1975, contracts between KPL and ERG's predecessor for the sale of natural gas within the state of Kansas fell within the provisions of the Kansas Act. Section 55-1404 of the Kansas Act provides that, in determining prices set by indefinite price escalators, no consideration shall be given to ceiling

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> of 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, whichever is later . . . .

Energy Reserves Group, Inc. v. Kansas Power & Light Co., 230 Kan. 176, —, 630 P.2d 1142, 1145 (1981).

67. The price redetermination clauses gave the seller the option to have the price of its gas redetermined every two years.

> [T]he parties shall mutually redetermine the price by considering three (3) contracts under which the highest prices are actually being paid for flowing gas ninety (90) days prior to the date the redetermined price is to be effective. The contracts to be considered shall . . . be for gas produced in Kansas . . . .

Id.

68. *See supra* note 3.

69. For example, if a governmental authority fixes a price for natural gas higher than the price under the contracts, a governmental price escalator clause allows the contract price to be adjusted to that higher price. 103 S. Ct. at 701.

70. *Id.* In June 1978 the Commission granted KPL an automatic pass-through of wholesale gas cost increases upon written notice, retaining the authority to review and revoke any such pass-through under normal standards for reviewing rate increases. *Id.* at 702 n.3.

71. *Id.* at 701.

72. KAN. STAT. ANN. §§ 55-1401 to -1415 (1983).

73. *Id.* § 55-1403. "Only natural gas purchase contracts entered into before April 20, 1977, providing for the sale, within this state, of natural gas produced in this state and not committed or dedicated to interstate commerce on November 8, 1978, shall be subject to the provisions of this act." *Id.*

The dates were not selected randomly. April 20, 1977, was the date President Carter announced plans to place permanent price controls on all natural gas production. *See supra* note 58. November 8, 1978, was the day before the NGPA was enacted. *See supra* text accompanying note 59.

prices set by federal authorities or prices paid in Kansas under other contracts.[74] Section 55-1405 limits the monthly price of old intrastate gas to the maximum allowed under section 109(b) of the NGPA.[75]

In November 1978, ERG requested a gas price increase to the section 102 level pursuant to the governmental price escalator clause.[76] KPL failed to file a timely pass-through application with the Commission, did not obtain Commission approval for the pass-through, and announced it would not pay the increased price.[77] When ERG attempted to terminate the contracts, KPL asserted that the Kansas Act denied ERG the right to receive an increase pursuant to section 102.[78] Thereupon, ERG requested an increase to the section 102 ceiling price under the price redetermination clause.[79] KPL responded that section 55-1404 of the Kansas Act extinguished KPL's obligation to comply with the price redetermination clause.[80]

In a declaratory judgment action, ERG contended that sections 55-1404 and 55-1405 of the Kansas Act violated the contract clause because they diminished the effect of the indefinite escalator clauses in the contracts by limiting the increases allowed under the NGPA. The Kansas trial court found that the Kansas Act did not violate the contract clause of the United States Constitution and that the NGPA's imposition of ceiling prices on intrastate gas did not trigger the governmental escalator clause.[81] Both the Kansas Supreme Court and the United States Supreme Court affirmed the trial court's findings.[82]

3. The *Energy Reserves* Standard

An initial reading of Justice Blackmun's opinion for the Court may leave the reader perplexed since the Court determined that there was not a sufficient impairment of ERG's contract to give rise to a con-

74. KAN. STAT. ANN. § 55-1404 (1983).

75. *Id.* § 55-1405. The NGPA provided for higher ceiling prices in order to stimulate new production. 103 S. Ct. at 702. The apparent rationale for limiting the increases allowed for old intrastate gas was that there was no need to encourage production of gas that was already being produced. Brief for Appellee at n.64 and accompanying text, Energy Reserves Group, Inc. v. Kansas Power & Light Co., 103 S. Ct. 697 (1983) (available Aug. 1, 1983, on LEXIS, Genfed library, Sup. Ct. Brief file).

76. 103 S. Ct. at 703.

77. *Energy Reserves*, 230 Kan. at —, 630 P.2d at 1146-47.

78. 103 S. Ct. at 703.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 710; 230 Kan. at —, 630 P.2d at 1154.

tract clause claim.[83] Despite the fact that the remaining points were unnecessary to resolve the constitutional issue,[84] Blackmun authored a full-blown analysis of the contract clause. This is unusual since the Court normally avoids dealing with constitutional issues not essential to its decision. Therefore, it is logical to conclude that the additional discussion is included to clear up the confusion created by *Allied Structural Steel* and *United States Trust*.[85] As a result of Blackmun's efforts, the *Energy Reserves* opinion pulls together the scattered odds and ends of earlier cases and establishes a uniform contract clause standard.

Reduced to its barest essentials, the appropriate standard evinced by the *Energy Reserves* Court is as follows: A state is constitutionally justified in substantially impairing contractual obligations if the state regulation is addressed to "a significant and legitimate public purpose . . . such as the remedying of a broad and general social or economic problem"[86] and the means selected to achieve that end is based "upon reasonable conditions and of a character appropriate to the public purpose."[87] Determination of the reasonableness and necessity of the means selected is normally deferred to the state legislature unless the state is a contracting party.[88]

Allied Structural Steel made it clear that the initial inquiry should be whether a substantial contractual impairment actually exists.[89] It is not enough that state legislation minimally impairs the party's contract;[90] the challenging party must have relied upon receiving performance of the impaired portion of the contract.[91] If the Court

83. Since § 602(a) of the NGPA left the states with the option of establishing lower minimums for natural gas than those established by the NGPA, 15 U.S.C. § 3601 (1982), and the State of Kansas had extensively and intrusively supervised the natural gas industry in the past, 103 S. Ct. at 706 & n.18, none of ERG's contractual expectations were impaired by the State of Kansas' action in regulating natural gas prices. *Id.* at 708. The contracts stated that neither party was liable for default for compliance with present and future state and federal laws. *Id.* at 707.

84. Justice Powell wrote a concurring opinion, joined by Chief Justice Burger and Justice Rehnquist, which lamented this judicial overkill. They questioned the necessity of further inquiry since no substantial impairment was found. 103 S. Ct. at 710.

85. It appears that the Court desired to clarify its position on the contract clause in part to avoid continuing litigation in other states on essentially the same issues. Almost identical statutes exist in Oklahoma, OKLA. STAT. tit. 52, §§ 260.1-.13 (1982), and New Mexico, N.M. STAT. ANN. §§ 62-7-1 to -9.1 (Supp. 1983), and similar litigation was under way in United States District Court for the Western District of Oklahoma, Energy Consumers & Producers Ass'n v. Baker, Nos. 79-320-D; 79-823-D (W.D. Okla. filed Mar. 20, 1979) (withdrawn June 7, 1983).

86. 103 S. Ct. at 705.

87. *United States Trust*, 431 U.S. at 22, *quoted in Energy Reserves*, 103 S. Ct. at 705.

88. 103 S. Ct. at 705-06.

89. 438 U.S. at 244.

90. *Id.* at 245.

91. *Id.; see supra* note 46.

determines that a severe impairment does exist, the inquiry then is pushed "to a careful examination of the nature and purpose of the state legislation."[92] *Energy Reserves* retains this determination as the first consideration.[93]

Two factors influenced the *Energy Reserves* Court's finding that a substantial impairment did not exist. First, although it is true that the contracts indicated that indefinite escalator clauses were placed there for the purpose of compensating ERG for "*anticipated* increases in the value of [its] gas,"[94] the Court found it unlikely that ERG had relied upon the clauses to give them a windfall from the deregulation brought about by the NGPA.[95] Secondly, the contracts involved natural gas, which had been the subject of heavy regulation in Kansas for more than seventy-five years.[96] Therefore, ERG should have entered the contract with full knowledge that the agreement was subject to any future restrictions that Kansas might place on the price. In fact, the contract stated that it was subject to "relevant present and future state and federal law."[97] This suggests that ERG knew or should have known that the state might regulate the price it was entitled to receive.

Finding no substantial impairment, the Court was without reason to investigate further, but Justice Blackmun's opinion proceeds as if such an impairment existed.[98] A simple reading of the opinion does not reveal the necessity for this continued discussion, but it is reasonable to assume that the Court recognized the opportunity to clear up the uncertainty created by *United States Trust* and *Allied Structural Steel* regarding the Court's role in scrutinizing state legislation.[99] Accordingly, the Court proceeds to hold that an impairment is justified only if there is "a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem."[100] The finding of a legitimate public purpose assures

92. 438 U.S. at 245.

93. 103 S. Ct. at 704-05.

94. *Id.* at 707 (emphasis in original). The clauses were also included to compensate ERG for increases in operating costs. *Id.* at 701.

95. *Id.* at 705-06.

96. *Id.* at 706 n.18.

97. *Id.* at 707; *see also supra* text accompanying notes 18-20 (contract incorporates positive law of the state).

98. 103 S. Ct. at 708.

99. *See supra* text accompanying notes 47-51.

100. 103 S. Ct. at 705. This portion of the standard has its historical origins in the *Blaisdell* decision, which required that legislation be addressed to a *legitimate* end. 290 U.S. at 445; *see supra* text accompanying note 25. Subsequently, both the *Allied Structural Steel* and *United States Trust* Courts required the finding of an *important* public purpose. *Allied*, 438 U.S. at 247; *United*

that the "State is exercising its police power, rather than providing a benefit to special interests."[101]

The Supreme Court identified two public concerns with which the Kansas Act dealt. First, the Court concluded that the State of Kansas was justified in using its police powers "to protect consumers from the escalation of natural gas prices caused by deregulation."[102] Secondly, the Court also believed the State had a legitimate interest in correcting the imbalance between interstate and intrastate markets.[103] While the Court is correct in finding that these two interests affected the public, it is not entirely clear that they were sufficient to justify impairing ERG's contracts.

It appears that the State of Kansas was correct in trying to protect consumers[104] from increased gas utility costs brought on by deregulation, although a fairly persuasive argument exists to the contrary. While it is true that KPL produced evidence that Kansas consumers would pay an estimated additional $128 million,[105] a possibly conservative estimate,[106] it does not necessarily follow that the actual impact would have been that severe. Even supporters of the bill admitted that the Kansas Act would only "provide a modicum of restraint on some utility price increases."[107] The effects of the price escalations

States Trust, 431 U.S. at 25. *Energy Reserves* describes a *significant* and *legitimate* public purpose as being a remedy to a "broad and general social or economic problem." 103 S. Ct. at 705.

101. 103 S. Ct. at 705.

102. *Id.* at 708.

103. *Id.*

104. ERG initially argued that consumer protection from the effects of deregulation was contrary to any significant and legitimate public concern because the legislation was not for the benefit of the public but for the special interests of KPL. Brief for Appellant at nn.41-44 and accompanying text, Energy Reserves Group, Inc. v. Kansas Power & Light Co., 103 S. Ct. 697 (1983) (available Aug. 1, 1983, on LEXIS, Genfed library, Sup. Ct. Brief file). ERG based its argument on the fact that KPL could automatically pass its costs on to consumers through exercise of the purchased-gas adjustment clause. *Id.* However, such pass-through could be revoked by the Commission, and in fact, KPL was denied the authority to pass the § 102 increase on to consumers. *Id.* at n.45.

Notwithstanding this denial, ERG's argument was flawed because KPL still could have passed the costs on to consumers through normal rate increase proceedings. *See* KAN. STAT. ANN. § 66-117 (1980). The difference is that the PGA clause, if allowed, would have permitted an automatic increase, whereas the normal rate increase proceeding would have required KPL to give 30-days notice before each increase. *Id.* In any event, the bulk of the costs would have been passed on to consumers under the theory that public utilities are entitled to earn a reasonable rate of return on their investments. It seems unlikely that a rate hike to cover increased operating expenses incurred by KPL because of increased gas purchase prices would have been denied.

105. Brief for Appellee at n.70 and accompanying text, *Energy Reserves*.

106. *Id.* at n.24. Nationwide figures were proving to be about 10-13% higher. *Id.* If these percentage figures were applicable in Kansas, the actual amount would have been closer to $140 million, assuming this remained constant through 1984.

107. Brief for Appellant at n.44 and accompanying text, *Energy Reserves*.

would have been considerably greater in some states,[108] but in Kansas less than ten percent of all natural gas sold was affected by the Kansas Act limitations.[109] No doubt the deregulation would have had an effect in Kansas; therefore, the Kansas Act served a *legitimate* public purpose. However, given the limited effect of deregulation in Kansas, it is not apparent that the Act served a *significant* public purpose.

It is not entirely clear from the Court's opinion what is meant by "correcting the imbalance between the interstate and intrastate markets."[110] The Court seems to recognize that the State of Kansas has a legitimate interest in protecting the Kansas natural gas market from the interstate market. If the price of unregulated intrastate gas climbs significantly higher than gas available on the regulated interstate market, the price differential encourages Kansas purchasers to buy out of state.[111] It is pure speculation, however, to say that the Court upholds a finding of a significant and legitimate public purpose on this basis because the opinion explains very little.[112] The Court left little doubt that if a substantial impairment is found in legislation, it is justified only if there is a significant and legitimate public purpose behind it.[113] It is not clear, however, how closely the Court will investigate alleged public purposes.[114]

If a legitimate public purpose can be identified, "the next inquiry is whether the adjustment of the 'rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a char-

108. *See infra* notes 121-34 and accompanying text.

109. Brief for Appellant at nn. 42-43 and accompanying text, *Energy Reserves*. The uncontradicted evidence put forth by ERG indicated that less than one-fourth of all gas consumed in Kansas is classified as intrastate gas. Secondly, less than 10% of the intrastate gas contracts contain indefinite price escalators. Of that figure, not all are contracts for old intrastate gas covered by the Kansas Act. *Id.*

110. 103 S. Ct. at 708. This purported public purpose was not discussed in the opinion written by the Kansas Supreme Court, 230 Kan. 176, 630 P.2d 1142.

111. *See generally* Harrison & Formby, *Regional Distortions in Natural Gas Allocations: A Legal and Economic Analysis*, 57 N.C.L. REV. 57, 87 (1978) (discusses the shift of purchases in producing states from intrastate gas to interstate gas).

112. 103 S. Ct. at 708. There is even an absence of discussion of the importance of balancing these two markets in KPL's brief. *See* Brief for Appellee at nn. 84-115 and accompanying text, *Energy Reserves*.

113. 103 S. Ct. at 705.

114. A footnote in the opinion may explain the Court's failure to closely examine the legitimacy of the alleged public purposes. The footnote indicates that the public purpose should be more carefully scrutinized if there is evidence that the political process has broken down. *Id.* at 708 n.25. The Court made a conclusory statement that no such problem existed in *Energy Reserves*. *Id.* The Court cites a law review Note that advocates deferring the choice of public purposes and determinations of necessity and appropriateness to state legislatures, unless the legislative process has broken down. For the full text of this Note, which develops an entire process-oriented approach to the contract clause, see Note, *supra* note 30.

acter appropriate to the public purpose justifying [the legislation's] adoption.' "[115] Proper assessment of the means selected by the state was left in disarray by the *Allied Structural Steel* decision.[116] The Court proceeded to clear up some of the mystery in *Energy Reserves* by pointing out that unless the state is a contracting party, courts properly should defer the determination of the reasonableness and necessity of the means selected to the legislature.[117] This signals a return of the distinction between private and public contracts that had been blurred by the *Allied Structural Steel* decision.

Since the contracts in this case were between private parties, the Court could properly defer to Kansas' judgment. The Court follows this approach, although Justice Blackmun briefly discusses the propriety of the Kansas Act as a reasonable and appropriate means of effectuating the purposes of the Act.[118] If the Kansas legislature hoped to protect Kansas markets from the lower interstate market, it is not readily apparent that reducing the price of intrastate gas already under contract brought about that result.[119] A purchaser such as KPL could not get interstate gas any cheaper absent the Kansas Act because it was already contractually committed for current gas needs.[120]

III. Impact of the Decision

There was perhaps more interest in Oklahoma in the outcome of this case than in Kansas.[121] Oklahoma interest stemmed from the fact

115. 103 S. Ct. at 705 (quoting *United States Trust*, 431 U.S. at 22).

116. *See supra* notes 45-50 and accompanying text.

117. 103 S. Ct. at 705-06. "Unless the State itself is a contracting party . . . '[a]s is customary in reviewing economic and social regulation' . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.' " *Id.* (quoting *United States Trust*, 431 U.S. at 22-23).

118. *Id.* at 709.

119. It is apparent that reducing the cost of new intrastate gas or old intrastate gas under a new contract would protect intrastate gas from the low-cost interstate gas. *See* Harrison & Formby, *supra* note 111, at 87.

120. It is possible that the Court envisioned a situation in which purchasers would be encouraged to breach the existing contract, pay damages, and negotiate a new interstate contract at a much lower price.

121. Evidence of this interest can be seen in the number of motions made by various Oklahoma groups to file amicus curiae briefs. A joint motion in support of ERG was filed by the Energy Consumers & Producers Association, Oklahoma Independent Petroleum Association, Service Drilling Co., Harrison L. Townes, Inc., Southland Drilling & Production Co., L.O. Ward, and Amerada Hess Corporation. Joint Motion for Leave to File Brief Amicus Curiae of Energy Consumers & Producers, Energy Reserves Group, Inc. v. Kansas Power & Light Co., 103 S. Ct. 697 (1983) (available Aug. 1, 1983, on LEXIS, Genfed library, Sup. Ct. Brief file).

A brief in support of KPL was submitted jointly by Oklahoma Natural Gas Co., Oklahoma Gas & Electric Co., Public Service Co. of Oklahoma, and the Oklahoma Association of Electric

that the Oklahoma Natural Gas Price Protection Act (Oklahoma Act)[122] served as a model for the Kansas Act.[123] Additionally, many long-term contracts for intrastate gas in Oklahoma contain indefinite price escalator clauses,[124] and increases from those clauses may be passed through to consumers upon approval by the Oklahoma Corporation Commission.[125] This situation is very similar to the one in Kansas, but additional interest was generated by the fact that almost one billion dollars was potentially at stake in Oklahoma.[126] This is almost eight times the figure involved in Kansas.[127] Perhaps because of this dollar incentive, *Energy Consumers & Producers Association v. Baker*[128]

Cooperatives. Brief Amicus Curiae of Oklahoma Natural Gas Co., *Energy Reserves*. One brief was submitted by the Attorney General of Oklahoma on behalf of the Oklahoma Corporation Commission and the State of Oklahoma. Motion for Leave to File Brief Amicus Curiae, *Energy Reserves*.

122. OKLA. STAT. tit. 52, §§ 260.1-.13 (1981).

123. Brief Amicus Curiae of Oklahoma Natural Gas Co. at 2, *Energy Reserves*.

124. *See* Answer Brief of Intervenor-Defendant Oklahoma Natural Gas Co. at 1, Energy Consumers & Producers Ass'n v. Baker, Nos. 79-320-D; 79-823-D (W.D. Okla. filed Mar. 20, 1979) (withdrawn June 7, 1983). This brief refers to stipulations filed and dated March 20, 1980, including Stip. ¶ 14, which indicates that 70% of Oklahoma Natural Gas contracts contained indefinite price escalator clauses. Stip. ¶ 12 indicates that two types of indefinite escalator clauses existed in long-term ONG gas contracts: price redetermination clauses and two-party favored nation clauses. Both clauses are affected by the Oklahoma Act. OKLA. STAT. tit. 52, § 260.4 (1981).

Redetermination clauses allow periodic renegotiation or redetermination of the contract price. The price is usually related to current prices being paid in the field or area at the time of renegotiation. The clause usually establishes a standard to determine the contract price such as the average of the two or three highest prices being paid in the field or area. *See* 4 H. WILLIAMS, OIL & GAS LAW § 726, at 752-53 (1980).

Two-party favored nation clauses stipulate that if a buyer purchases gas in the same field or area at a higher price than is paid under the contract in question, the buyer must thereafter pay the seller the same price it is paying to other sellers. *Id.* at 748.5. In other words, the buyer must not favor one seller over another in a particular area; it must pay the highest price allowed in any contract. *See Natural Gas Regulation and Market Disorder*, 18 TULSA L.J. 619, 627 n.53 (1983).

As of November 30, 1979, ONG was purchasing gas from 25 counties in which the § 102 price was being paid. See Stip. ¶¶ 18-19. Consequently, § 105 of the NGPA would have required ONG to pay the § 102 price on their old intrastate gas contracts that contained indefinite escalator clauses. However, the Oklahoma Act limited the effect of indefinite escalator clauses to the § 109 price. The December 1979 § 102 price was $2.336 per MMBtus whereas the § 109 price was $1.774 per MMBtus. *See* 18 C.F.R. § 271.101 (1983).

ONG rates are illustrative since ONG is the most directly affected utility, and its figures are used in this discussion for the sake of simplicity.

125. In addition to normal rate increase proceedings, public utilities in Oklahoma have automatic pass-through authority through use of fuel adjustment clauses. OKLA. STAT. tit. 17, §§ 251-257 (1981). This is almost identical to the rate increase procedure in Kansas. 103 S. Ct. at 702 n.3.

126. Brief Amicus Curiae of Oklahoma Natural Gas Co. at 19, *Energy Reserves; see* Oklahoma Natural Gas Co., Estimated Impact (Savings) of S.B. 49 on Oklahoma Utility Customers—ONG, PSO, and OG&E, 1979-1984, at 1 (1980) (unpublished study).

127. "The Legislature determined that the Price Protection Act would, between 1979 and 1984, foreclose almost $128 million in additional gas costs, assuming 10% annual gas price increases under the NGPA." Brief for Appellee at n.69, *Energy Reserves*.

128. Nos. 79-320-D; 79-823-D (W.D. Okla. filed Mar. 20, 1979) (withdrawn June 7, 1983).

was filed by numerous Oklahoma natural gas producers against the Oklahoma Corporation Commission in an effort to have the Oklahoma Act declared unconstitutional and allow those producers to claim the higher price. Oklahoma Natural Gas (ONG) and the Oklahoma Association of Electric Cooperatives intervened as defendants. The case was held in abeyance until a decision was reached in *Energy Reserves*. The Supreme Court's decision was dispositive of the Oklahoma case, since the Court found no contract clause violation in the Kansas Act because no impairment was involved.[129] To the extent any impairment existed, the Court found it justified by less compelling interests than existed in Oklahoma. Challenges to the Oklahoma Act by Oklahoma gas producers appeared fruitless in light of *Energy Reserves*; it is, therefore, no surprise that the Oklahoma suit was dropped.

The estimated one billion dollar difference between the section 102 price and the section 109 price was forecast by ONG to cost residential customers an additional $44.78 in 1980, $58.01 in 1982, and $73.44 in 1984.[130] These figures were, of course, based on the assumption that a full pass-through would have been approved. Actual figures show that the estimated one billion dollar difference was conservative. According to Oklahoma Corporation Commission statistics, the price differential between sections 102 and 109 resulted in a savings of $616.5 million through 1982.[131] The Commission estimated that 1983-84 savings would be $474 million, making a total savings to customers of almost $1.1 billion.[132] This calculation does not account for indirect costs avoided.[133]

If there is any validity to these figures, there can be little doubt that a billion dollar increase in utility rates over a six-year period, with its attendant effects, would be sufficient for the State of Oklahoma to

129. *Energy Reserves*, 103 S. Ct. at 708.

130. Answer Brief of Intervenor-Defendant Oklahoma Natural Gas Co. at 28, *Energy Consumers*.

131. Duck, *Gas Pricing Decision 'Billion Dollar Ruling'*, Tulsa Tribune, Jan. 25, 1983, at 1B, col. 1.

132. *Id.* The news story that accompanies the Oklahoma Corporation Commission figures incorrectly states that Oklahomans would have had to refund more than $1 billion to Oklahoma gas producers and pay an additional $500,000 over the next two years. The chart illustrates that these figures should have been $616.5 million and $474 million, respectively. *Id.* at col. 5.

133. Of concern to residential customers would have been the potential indirect effect brought about by an escalation of prices charged to industrial customers if industries had chosen to switch to an alternative fuel. *Natural Gas Regulation and Market Disorder, supra* note 124, at 623. The resulting loss of revenue to the utilities probably would have been passed through to remaining customers in the form of higher prices. Answer Brief for Intervenor-Defendant at 30, *Energy Consumers*.

find a significant and legitimate public purpose in protecting its utility customers and economy. These interests allowed Oklahoma to exercise its police powers to legislatively impair contracts between public utilities and producers of natural gas.[134]

The current natural gas glut[135] gives *Energy Reserves* added significance in Oklahoma. The decision grants marginal relief to the high prices that have prevailed during the glut[136] by allowing the Oklahoma Act to limit the effect of indefinite price escalators. Were this not the case, old intrastate gas contracts with indefinite escalator clauses in Oklahoma would receive the higher section 102 price as opposed to the section 109 price.[137]

Of greater importance, however, is the position assumed by *Energy Reserves* within the larger framework of the nationwide gas surplus. The gas industry crisis calls into question the conventional wisdom of entering into long-term purchase agreements[138] that have been considered essential to assure purchasers—pipelines and industrial customers—the necessary revenue to recover their investment in pipeline equipment.[139] These contracts are proving to be troublesome in today's market because they do not respond well to changes in supply and demand,[140] and when prices under contracts do change, it is generally

134. Considering the fact that the almost-identical Kansas Act passed constitutional muster in *Energy Reserves*, it seems safe to assume that Oklahoma's adjustment of the rights and responsibilities of contracting parties under the Oklahoma Act is reasonable and appropriate. *See supra* text accompanying notes 95-104.

135. *See, e.g.*, Tussing & Barlow, *A Survival Strategy for Gas Companies In the Post-OPEC Era*, PUB. UTIL. FORT., Feb. 3, 1983, at 13; *Natural Gas Regulation and Market Disorder, supra* note 124, at 637; *Cheaper Gas Will End Glut*, Tulsa Tribune, Sept. 27, 1983, at 1B, col. 6.

136. The high prices were brought on for several reasons, including partial decontrol allowed under the NGPA, recession, and high priced long-term contracts negotiated during the shortages of the late 1970's. *Industry in Crisis*, Tulsa Tribune, Feb. 16, 1983, at 9F, col. 1; *see also* Hagar, *Deliverability Surplus Keeps U.S. Natural Gas Industry in Quandary*, OIL & GAS J., June 6, 1983, at 25 (points to the NGPA, decreased demand because of high prices, a warm winter in 1982-83, and economic recession as being factors contributing to high prices and the glut).

137. *See supra* notes 60-62 and accompanying text.

138. Tussing & Barlow, *supra* note 135, at 16; *see also* Hagar, *supra* note 136, at 28 (illustrates the recognition by one industry member that more short-term contracts and different types of long-term contracts are part of the future for the industry).

139. *See, e.g.*, Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 VA. L. REV. 63, 77 (1982); *Natural Gas Regulation and Market Disorder, supra* note 124, at 625; *see also* Tussing & Barlow, *supra* note 135, at 16 (points to the need in the 1950's for long-term agreements before lenders would extend credit and the FPC would certify a plant).

140. *Industry in Crisis, supra* note 136, at 10F, col. 1. Many long-term gas contracts contain a variety of clauses aimed at giving flexibility to these agreements. The indefinite escalator clauses in *Energy Reserves* and the Oklahoma litigation are examples. *See generally* Pierce, *supra* note 139, at 77-82 (discussing the various types of provisions often included in gas contracts); *Natural Gas Regulation and Market Disorder, supra* note 124, at 625-28 (same). Even so, some of these clauses do not always accurately reflect market conditions. *Id.* at 627.

upward.[141] As a result, purchasers have been using whatever means possible to terminate contracts, including flat refusals to honor contractual commitments.[142] Against this backdrop, it becomes clear that such industry problems could arouse the interest of state legislatures.

It is clear from *Energy Reserves* that states can modify intrastate natural gas contracts when a significant and legitimate public purpose is served.[143] This interpretation of the contract clause is buttressed by the *Exxon Corp. v. Eagerton* decision[144] in which the Court approved Alabama's regulation of intrastate oil and gas contracts[145] because the modification advanced a " 'broad societal interest' . . . in protecting consumers from excessive prices."[146] In view of the Court's apparent reluctance to overturn state legislation on a contract clause basis, it is entirely possible that if long-term intrastate gas contracts between producers and purchasers result in high prices to consumers or great price disparities between the interstate and intrastate gas markets, states could modify these contracts without fear that the contract clause would act as a bar. This possibility is illustrated by the recent passage of the New Mexico Natural Gas Price Protection Act.[147] In enacting this bill, the New Mexico legislature found that the average price for intrastate gas in New Mexico has risen rapidly in the past five years.[148] The legislature also found that a disparity exists between natural gas

141. *Industry in Crisis, supra* note 136, at 10F, col. 1.

142. Some contracts contain "market-out" clauses that allow the purchaser to lower the contract price to a point where the gas can be marketed. *Natural Gas Regulation and Market Disorder, supra* note 124, at 627. Where these clauses exist, they are being exercised. If they do not exist, implied theories of a right to get out of "economically unreasonable" contracts are being argued. Tussing & Barlow, *supra* note 135, at 15. Some purchasers are attempting to justify their refusal to take gas on a "force majeure" defense. *See, e.g., id.*; Hagar, *supra* note 136, at 28; *Ruling Enforces Gas Purchase Contract*, Tulsa Tribune, June 28, 1983, at 2B, col. 1. Others are simply refusing to comply, preferring to take their chances in a lawsuit rather than pay for gas they can not sell. Tussing & Barlow, *supra* note 135, at 15.

143. 103 S. Ct. at 705.

144. 103 S. Ct. 2296 (1983).

145. The contract clause dispute centered around an increased severance tax imposed by the State. *Id.* at 2299. The amendment creating the tax required that the tax be levied only upon the producer or the severer of the oil or gas and not passed through to consumers. *Id.* at 2300. The appellants, producers of oil and gas within the state, were parties to contracts requiring purchasers to reimburse them for severance taxes paid. *Id.* The appellants challenged the pass-through prohibition as being violative of the contract clause since the amendment denied them the right to pass these costs on to their purchasers pursuant to their contract rights. *Id.* at 2305. The Court agreed that the appellants' contract rights were impaired but found no violation of the contract clause. *Id.* at 2305-07.

146. *Id.* at 2306 (quoting *Allied Structural Steel*, 438 U.S. at 249).

147. New Mexico Natural Gas Price Protection Act, ch. 123, 1984 N.M. Laws 219 (to be codified as amended at N.M. Stat. Ann. §§ 62-7-11 to -23).

148. *Id.* § 2(A)(2).

sold on the interstate and intrastate markets and attributes this disparity "to the interaction of intrastate contractual provisions and federal wellhead pricing regulations."[149] With these findings in mind and in light of the public interest in natural gas production,[150] the legislature stated that the Act's purposes are to ensure tolerable prices for intrastate gas and, as far as it is practicable, to assure that customers purchasing New Mexico gas on the interstate market pay comparable prices.[151] To achieve this end, the Act limits the price for intrastate gas drilled prior to November 9, 1978, to the section 109 price allowed under the NGPA.[152] The obvious effect is to alter contracts between private parties, but despite this impairment, the New Mexico legislature was not reluctant to pass the bill. This action may be attributable to the Supreme Court's current interpretation of the contract clause.

IV. CONCLUSION

The *Energy Reserves* decision is important for several reasons. The decision marshals the elements of contract clause analysis to identify clearly the proper standard and lays to rest the confusion that surrounds the clause. The decision is also important to Oklahoma because it legitimized the Oklahoma Act and prevented a billion-dollar price increase that would likely have been borne by Oklahoma consumers of natural gas. Finally, the decision is important because it leaves open the possibility that the Court's liberal interpretation of the contract clause might lead states to rearrange long-term contractual rights that are plaguing the nation's gas industry in order to protect both the industry and consumers of natural gas.

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149. *Id.* § 2(A)(7).
150. *Id.* § 2(A)(1).
151. *Id.* § 2(B).
152. *Id.* § 5.