

in the

# Supreme Court of the United States

ENERGY RESERVES GROUP, INC., )

Appellant )

v. )

NO. 81-1370 )

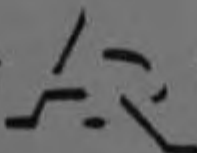
THE KANSAS POWER AND LIGHT )  
COMPANY )

Washington, D. C.

November 9, 1982

Pages 1 - 45

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1           IN THE SUPREME COURT OF THE UNITED STATES

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3   ENERGY RESERVES GROUP, INC.           :

4                   Appellant           :

5           v.                               :   No. 81-1370

6   THE KANSAS POWER AND LIGHT           :

7   COMPANY                               :

8   - - - - -x

9                               Washington, D.C.

10                   Tuesday, November 9, 1982

11           The above-entitled matter came on for oral  
12 argument before the Supreme Court of the United States  
13 at 11:47 o'clock a.m.

14 APPEARANCES:

15 GARY W. DAVIS, ESQ., Oklahoma City, Oklahoma; on  
16   behalf of the Appellant.

17 BASIL W. KELSEY, ESQ., Kansas City, Missouri;  
18   on behalf of the Respondent.

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1                                P R O C E E D I N G S

2                    CHIEF JUSTICE BURGER: We will hear arguments  
3 next in Energy Reserves Group against Kansas Power and  
4 Light.

5                    Mr. Davis, I think you may proceed whenever  
6 you're ready.

7                    ORAL ARGUMENT OF GARY W. DAVIS, ESQ.

8                    ON BEHALF OF APPELLANT

9                    MR. DAVIS: Thank you, Mr. Chief Justice, and  
10 if the Court please:

11                   The central issue in this case is whether or  
12 not a Kansas statute known by its framers as the Kansas  
13 Natural Gas Price Protection Act, is in violation of the  
14 contract clause of the United States Constitution.

15                   There is no argument in this case that this  
16 particular Kansas statute does impair two natural gas  
17 purchase and sales contracts between Energy Reserves and  
18 Kansas Power and Light Company. There is also no  
19 question that this impairment occurs from five to six  
20 years, and not only does it incur -- not only does it  
21 prevent Energy Reserves from receiving a substantial  
22 portion of the consideration that they would have  
23 received, it also prevents it from receiving its  
24 contracted right of termination if it could not receive  
25 the money that it was supposed to receive under the

1 contract.

2           Kansas Power and Light Company's answer to  
3 this impairment is that it violates -- that it is within  
4 the reserve police power of the State of Kansas.

5           Underk the decisions of this Court in Home  
6 Building and Loan Association v. Blaisdell, United  
7 States Trust v. the State of New Jersey, Allied  
8 Structural Steel v. Spannaus, this Court set forth  
9 certain tests of reasonableness, and also that the  
10 statute must be of a character justifying the use of the  
11 police power.

12           The points that I want to make are four, and  
13 thse are that in the first place, these contracts would  
14 not have been entered into without these pricing  
15 provisions that have been impaired.

16           Secondarily, I want to point out that the  
17 impairment to ERG, Energy Reserves, is severe.

18           Thirdly, I'd like to point out that this  
19 statute has an extremely narrow focus, is very limited  
20 in its application.

21           And the fourth point that I want to make is  
22 that this statute serves no broad societal benefit, and  
23 in fact, does not solve any emergency or any supposed  
24 emergency that it is supposed to solve.

25           The facts in this case are that in September

1 of 1975, after months of negotiations, the parties  
2 finally agreed to the terms of these two contracts that  
3 are involved. These are what you call long term natural  
4 gas contracts. One is for the life of the gas field and  
5 the other is for the life of a gas processing plant.  
6 They have a duration of 20 to 30 years.

7           The two pricing provisions that are involved,  
8 the first one is one that says that in the event that  
9 there is a price prescribed for the gas involved that is  
10 higher than the price that is being paid under this  
11 contract by any governmental authority, then that new  
12 price as prescribed by government would be the new price  
13 under the contract.

14           The second pricing provision that's involved  
15 here is what is known as a pricing redetermination  
16 provision. It's in the -- and what this does, it's  
17 every two years, Energy Reserves is entitled to come to  
18 KP&L and say that we want our price redetermined. We  
19 want it redetermined on the basis of what is being paid  
20 for other gas in the State of Kansas under like  
21 contracts. It's a pricing provision that is designed  
22 to, during the long term of these contracts, to assure  
23 Energy Reserves that it is always receiving a price that  
24 is akin to the market price.

25           QUESTION: Mr. Davis, may I ask you whether

1 the prices under the contract here had increased under  
2 that second clause before the Kansas legislature passed  
3 the act here?

4 MR. DAVIS: Yes, Justice O'Conner, it did.  
5 The price increased at the first opportunity in 1977,  
6 and it increased from \$1.52 a million Btu to \$1.77 a  
7 million Btu.

8 QUESTION: Mm-hmm.

9 And that was when?

10 MR. DAVIS: In 1977.

11 QUESTION: Does the act retroactively apply,  
12 the Kansas act, to --

13 MR. DAVIS: It definitely does retroactively  
14 apply, and the Supreme Court of Kansas so held.

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1           The other provision in the contract that I'd  
2 like to call to the Court's attention is what's known as  
3 the intent provision; and this intent provision  
4 specifically provides that the point of these two price  
5 escalation provisions was to provide ERG during the term  
6 of the contract the anticipated increase in the natural  
7 gas price.

8           Now, I want to point out also that these price  
9 escalation provisions are not automatically imposed upon  
10 KP&L. When a price escalation occurs under one of these  
11 pricing provisions, then KP&L is obligated to go to the  
12 Kansas Corporation Commission and seek its approval to  
13 pass through all or a part of any price increase under  
14 either one of these provisions. And this KP&L did when  
15 the first price increase came around.

16           KP&L then has the obligation if it can't get  
17 it passed through, then KP&L can either say we're going  
18 to buy this gas and take it out of our profits, or they  
19 can tell Energy Reserves we couldn't get approval to  
20 pass it through; therefore, we're not going to pay the  
21 increased price. And the Energy Reserves is then given  
22 an option under the contracts to terminate if it does  
23 not receive this increased price.

24           What happened was right after the 1977 or  
25 within a year after the 1977 redetermination the Natural



1 Gas Policy Act of 1978 was passed. This act authorized  
2 and prescribed a higher price for intrastate gas, which  
3 is what's involved here, than the price that was then  
4 being paid under the contract. It was that time on  
5 December 1, 1978 that Energy Reserves requested an  
6 increased price.

7 As I say, the KP&L then applied twice, once in  
8 December of '78 and once in February seeking a  
9 passthrough. Nothing happened. Things were going on in  
10 the legislature about what to do about this. And on May  
11 29, 1979, approximately six months after this first  
12 price increase would have been due, this particular act  
13 was passed. And what this particular statute does, it  
14 prevents either one of these clauses from ever coming  
15 into operation; and it also prevents Energy Reserves  
16 from exercising the contract right of determination if  
17 it doesn't receive one of these price increases.

18 QUESTION: Mr. Davis, if you were correct and  
19 your client were allowed to terminate its contracts,  
20 what price could it now charge under the Natural Gas  
21 Act, under the NGPA? What section would control the  
22 price, if you were right?

23 MR. DAVIS: There would be two possibilities.  
24 One would be under this government escalation price  
25 which would be the Section 105 price under the Natural

1 Gas Policy Act, which is -- Congress when they passed  
2 the Natural Gas Policy Act created a special category  
3 for intrastate gas that was under contract at the time.

4 The other price provision that would of course  
5 control would be this price redetermination provision  
6 which is a market price redetermination.

7 QUESTION: Is it clear that Section 109 would  
8 not apply?

9 MR. DAVIS: Your Honor, under the Kansas act  
10 this is one of the things that they say that makes the  
11 statute reasonable is that in lieu of getting the 105  
12 price or the price that we're entitled to under the  
13 contract, a market price, that we get the 109 price.

14 This Section 109 price of course is a special  
15 category of pricing that was set forth by the Natural  
16 Gas Policy Act. It is a substantially different price  
17 than the Section 105 price which is prescribed for  
18 natural gas, and it's a different price than we would  
19 receive under competitive conditions.

20 QUESTION: By "different" you mean lower?

21 MR. DAVIS: Yes, Your Honor. It definitely is.

22 QUESTION: Well, if the contract -- absent  
23 this contract what price could you charge?

24 MR. DAVIS: You mean, Your Honor, if we didn't  
25 have a contract?

1           QUESTION: Yes. Well, suppose that -- suppose  
2 -- suppose the contract was in force and you wanted a  
3 price increase, and the utility said sorry, we won't pay  
4 it, and you say well, we will then exercise our option  
5 to cancel the contract, so no contract. What price then  
6 would you --

7           MR. DAVIS: The price would be the same. It  
8 would be --

9           QUESTION: The price would be controlled by  
10 the Federal act.

11          MR. DAVIS: Which would be the Section 105  
12 price. That's exactly right.

13          QUESTION: And not the 109 price.

14          MR. DAVIS: Not the 109 price.

15          QUESTION: Well, but the Section 105 price  
16 applies to gas that's under contract, right?

17          MR. DAVIS: That's correct.

18          QUESTION: But isn't it your position that the  
19 gas would not be under contract?

20          MR. DAVIS: Your Honor, it wouldn't make any  
21 difference because the market price was precisely the  
22 same price as the 105 price.

23          QUESTION: Well, but if it's not under  
24 contract and if 105 doesn't apply, clearly 102 would not  
25 apply, so wouldn't 109 apply, and if so, wouldn't you

1 get an even lower price?

2 MR. DAVIS: Your Honor, but these contracts  
3 were under contract --

4 QUESTION: Well, but your position, as I  
5 understand, in this Court is that the contract doesn't  
6 cover this case. Or have I got it backwards? You're  
7 arguing that the gas -- that the contract does apply,  
8 aren't you?

9 MR. DAVIS: We're arguing that certainly the  
10 contracts do apply and that we're entitled to the relief  
11 that was afforded to us under the contracts.

12 QUESTION: I see.

13 QUESTION: The maximum relief you could get is  
14 be free of the contract.

15 MR. DAVIS: Absolutely, Your Honor.

16 QUESTION: And so if the utility said sorry,  
17 we won't pay the contract prices, your maximum release  
18 is to have no contract.

19 MR. DAVIS: Then we could go out and sell our  
20 gas in the intra --

21 QUESTION: To anybody you wanted to.

22 MR. DAVIS: To anybody we wanted to.

23 QUESTION: But would it be subject at all to  
24 the Gas Policy Act?

25 MR. DAVIS: No, Your Honor. It would only be

1 subject to the ceiling price as set forth for Section  
2 105 gas.

3 QUESTION: In Section 109, wouldn't it?

4 QUESTION: Well, yes.

5 QUESTION: That's the point.

6 MR. DAVIS: Section 105 applies to gas that  
7 was under contract at the time of the Natural Gas Policy  
8 Act. This gas was under contract.

9 QUESTION: You're saying "was under contract."

10 MR. DAVIS: Right. Until KP&L refused to pay  
11 the price increases.

12 I want to point out, Your Honor, that the  
13 Section 109 price is a vastly different price than this  
14 Section 105 price of the market price that would be  
15 obtained. As a matter of fact, KP&L at length --  
16 testified at length concerning these contracts in 1975  
17 before the Kansas Corporation Commission, and one of the  
18 things that they said was that Energy Reserves had a  
19 right at that time to alternatively not sell us gas for  
20 \$1.53 but sell it to the city of Wichita for \$2.04. The  
21 price that would become effective on December 1 --

22 CHIEF JUSTICE BURGER: We'll resume there at  
23 1:00.

24 MR. DAVIS: Right, Your Honor.

25 (Whereupon, at 12:00 p.m., the hearing was

1 recessed for lunch, to be resumed at 1:00 p.m., the same  
2 day.)

1 AFTERNOON SESSION

2 (1:00 p.m.)

3 CHIEF JUSTICE BURGER: You may continue, Mr.  
4 Davis.

5 ORAL ARGUMENT OF GARY W. DAVIS, ESQ.,  
6 ON BEHALF OF THE APPELLANT -- Resumed

7 MR. DAVIS: Thank you, Mr. Chief Justice, and  
8 if the Court please:

9 On this impairment question I want to just  
10 clarify one point, and that is that under Section 105,  
11 which is the section that applies to intrastate gas  
12 under the Natural Gas Policy Act, what that provides is  
13 in effect that you get the Section 102 price, which is a  
14 price substantially higher than the 109 price; and it  
15 also says that the effective thing is having a contract  
16 in existence on the effective date of the act, which was  
17 December 1, 1978, and then it also applies to any  
18 successor contract. And under Section 101 --

19 QUESTION: Well, what about the time when  
20 there isn't any contract?

21 MR. DAVIS: Your Honor, I'm sure that there --

22 QUESTION: It's irrelevant. If a contract  
23 expires, it's irrelevant because it was covered by a  
24 contract on the date of the act, is that it?

25 MR. DAVIS: A -- a success -- right, Your



1 Honor. A successor contract is a contract that would  
2 come on after this contract --

3 QUESTION: Yeah.

4 MR. DAVIS: -- Was terminated, and it would  
5 not need to be between the same parties, for example.

6 QUESTION: I see. I see.

7 MR. DAVIS: I just -- and also on this  
8 impairment question I want to point out that the Section  
9 109 price is vastly different from the Section 102  
10 price. It's about a dollar a million BTU right now. In  
11 1978, however, it was approximately 30 cents a million  
12 BTU, and it has gone up with inflation.

13 On the question of inducement, a member of the  
14 Board of Directors and officer of Kansas Power and Light  
15 Company testified at length in 1975 that these contracts  
16 would not have been entered into except for these  
17 escalation provisions. He also testified that the price  
18 of gas was going to increase everywhere, and he also  
19 testified concerning the fairness of these contracts,  
20 and that he pointed out that Energy Reserves had an  
21 option to sell its gas at that time rather than \$1.53 at  
22 \$2.04. The \$2.04 price is substantially the same price  
23 that existed under the Natural Gas Policy Act in 1978,  
24 December 1, 1978. In other words, the price that would  
25 be afforded to ERG under its contract with this first



1 price increase that's prevented is substantially the  
2 same price that KP&L testified ERG could have sold its  
3 gas for three years earlier.

4 This act is also bad and improper from the  
5 standpoint that it is extremely narrow in its focus. It  
6 covers only six per -- something less than six percent  
7 of all the gas produced in Kansas. It covers something  
8 less than 10 percent of the gas consumed in Kansas. It  
9 applies only to contracts that have these type of price  
10 escalation provisions which you would find in a  
11 long-term contract. In other words, their price where  
12 there are indefinite price escalator clauses as opposed  
13 to fixed price escalator clauses. A fixed price  
14 escalator clause could in fact result in a much higher  
15 price, and that is certainly not equitable. And, again,  
16 it applies only to contracts that were executed before  
17 April 20th, 1977. It applies only to contracts that are  
18 of long term.

19 QUESTION: Well, Mr. Davis, certainly the  
20 legislature has some right to target a particular area  
21 of perceived danger or problem, doesn't it, without  
22 making the rule that adopts for that area applicable  
23 right across the board.

24 MR. DAVIS: There can be no reasonable  
25 justification, Justice Rehnquist, for just picking out a

1 few contracts having a few types of contract clauses.  
2 There's no reasonable distinction that I can think of  
3 for picking out these particular contracts and applying  
4 it to this particular gas.

5 I think possibly the worst thing about these  
6 contracts is that it really doesn't serve the benefit  
7 that it's supposed to serve. Who gets the savings from  
8 this gas? On the testimony before the committee 69  
9 percent of the gas that KP&L -- KP&L buys goes to other  
10 utilities; it goes for industrial uses; it goes for  
11 sales to themselves for the generation of electricity.

12 And so there is no real finding that any  
13 benefit goes to any of the people who are supposed to be  
14 benefitted by this act. As -- just to quote the  
15 majority report that recommended this bill to the  
16 legislature, it would provide a modicum relief to some  
17 people who have the need for utility use of this gas.  
18 It's just extremely limited in nature, and its narrow  
19 scope totally condemns it.

20 QUESTION: Did the Federal act set a ceiling  
21 on the price of this gas?

22 MR. DAVIS: Yes, Your Honor, it did, which is  
23 --

24 QUESTION: And despite any provision in the  
25 contract.

1 MR. DAVIS: That is correct, Your Honor.

2 QUESTION: And that wouldn't be  
3 unconstitutional? You don't claim the Federal act was  
4 unconstitutional.

5 MR. DAVIS: No, sir, Your Honor. The contract  
6 clause just applies to State action, not to Federal  
7 action.

8 QUESTION: But if there were some -- you don't  
9 think the Federal act is vulnerable at all under  
10 provision of the Constitution.

11 MR. DAVIS: I personally do not, Your Honor.  
12 I think it's interesting to contrast the position of  
13 what was going on with the Natural Gas Act when the  
14 Federal Power Commission was regulating things and this  
15 Court, for example, in the Permian Basin Area Rate Cases  
16 where the Federal government was regulating price  
17 escalation provisions. They pointed out that one of the  
18 -- one of the things that provided some equity to the  
19 matter was the fact that even there where the Federal  
20 government was action, the part -- Federal government  
21 was acting, the parties could terminate the contracts.  
22 They didn't have to continue to sell them at these  
23 prices.

24 And, of course, this is one thing that makes  
25 the impairment in this case. Not only must ERG continue

1 to sell its gas at prices far below what it bargained  
2 for, but it can't even terminate the contracts.

3 QUESTION: Did -- did -- is there a preemption  
4 issue here?

5 MR. DAVIS: Your Honor, the Section 602 of the  
6 Natural Gas Policy Act provides that the states may  
7 enact lower prices for gas produced in the state than  
8 that prescribed by the act. It's not mandatory that  
9 they do so, and it's not an invitation that they do so.

10 There is a question -- in one of the amicus  
11 briefs in quoting the legislative history it was pointed  
12 out and believed that this was a ceding of the  
13 Interstate Commerce Power, and that this Section 602 not  
14 only provided a right in the states to prescribe a rate  
15 for intrastate gas but also for interstate gas.

16 QUESTION: But even if it did, it wouldn't  
17 reach the contract clause issue.

18 MR. DAVIS: That is correct, Your Honor.

19 QUESTION: It just would be a commerce issue.

20 MR. DAVIS: That's exactly right, but that's  
21 -- that's what -- if that's correct, that makes this  
22 statute even worse, because we're not talking -- it's  
23 just that much smaller percentage of the gas that you're  
24 regulating. It's just that much smaller of the gas that  
25 could be regulated, and it makes it that much more

1 discriminatory; in other words, where you just pick out  
2 intrastate gas and then you just pick out a piece of  
3 that intrastate gas to regulation.

4 QUESTION: Well, did the -- did the Kansas  
5 court rely on the federal act as precluding the  
6 operation of these clauses?

7 MR. DAVIS: No, Your Honor, it did not. It  
8 was strictly on the Kansas act, and it's only the Kansas  
9 act that precludes the operation of these two price  
10 provisions.

11 QUESTION: With respect to your point about  
12 kind of chopping up the market and it's just a small  
13 part of the market, doesn't the federal scheme work in  
14 somewhat the same way by differentiating between new gas  
15 and old gas and putting a lower price on the old gas?

16 MR. DAVIS: Your Honor, it also differentiates  
17 with regard to intrastate gas. As a matter of fact,  
18 under the legislative history of the Natural Gas Policy  
19 Act one of the things they were doing was sanctifying  
20 the present intrastate contract because there they were  
21 dealing with an area where -- where, for one, the gas  
22 would be covered by contracts that were not regulated.  
23 And that's why they set up, in my -- set up a special  
24 provision for intrastate gas prior to the NGPA and set a  
25 price that was comparable to the Section 102 price.

1 I'd just like to say in summary that in this  
2 case there has been -- there's no question that the  
3 parties would not have entered into these contracts but  
4 for these price escalation provisions. There is no  
5 question that ERG has been substantially impaired by  
6 this Kansas statute. There is no question that it is a  
7 statute that is extremely limited in scope. And there  
8 is no question -- and as I say, possibly the worst part  
9 of the statute is there is no finding that it really  
10 serves any benefit that is supposed to be served.

11 One of the amicus briefs, for example, said  
12 for KP&L, was to the effect that they had no way of  
13 knowing what relief, if any, was being afforded to the  
14 people who might really need some help as a result of  
15 increasing prices.

16 Thank you.

17 CHIEF JUSTICE BURGER: Mr. Kelsey.

18 ORAL ARGUMENT OF BASIL W. KELSEY, ESQ.,

19 ON BEHALF OF THE RESPONDENT

20 MR. KELSEY: Mr. Chief Justice, and may it  
21 please the Court:

22 The one issue necessarily before the Court in  
23 this case today is the constitutionality of state  
24 natural gas price controls. The Kansas Natural Gas  
25 Price Protection Act amounts to the intrastate corollary



1 of the Natural Gas Policy Act which was signed by the  
2 President four years ago today.

3 Before I begin my argument, however, I should  
4 like to clear up a question that Justice White put to  
5 Mr. Davis.

6 QUESTION: I hope you're clearing up the  
7 question, not the answer.

8 (Laughter.)

9 MR. KELSEY: Thank you for correcting me, Your  
10 Honor. I'll try to give you a clear answer.

11 QUESTION: Well, that's all right.

12 MR. KELSEY: I think Your Honor inquired as to  
13 what this gas could receive if it were to be sold in the  
14 interstate market upon the expiration of this contract.  
15 This gas is in fact controlled by Section 105(b)(1) of  
16 the Natural Gas Policy Act so long as this contract  
17 remains in effect. When the contract expires by its own  
18 terms, it would then be what is known under the NGPA as  
19 a rollover contract under Section 106 of the Natural Gas  
20 Policy Act. That section provides --

21 QUESTION: Would it be known that -- would it  
22 be classified that way if it expired by cancellation?

23 MR. KELSEY: No, it wouldn't, Your Honor. It  
24 would then be known as a successor contract and would be  
25 treated under --

1 QUESTION: Well, suppose -- suppose the --  
2 suppose the utility, your client -- is that your client,  
3 the utility?

4 MR. KELSEY: Yes. The Kansas Power and Light  
5 Company.

6 QUESTION: Yes. Suppose the utility said  
7 well, you've purpoorted to increase the price. We just  
8 won't pay it. And then the pipeline or the producer or  
9 the other side of the contract said we cancel the  
10 contract pursuant to its terms. Is that an expiration  
11 or --

12 MR. KELSEY: No, it isn't. Then any new  
13 contract entered into would be what is called a  
14 successor contract which is anything but a rollover  
15 contract.

16 QUESTION: And what would that -- then what  
17 would the controlling section be?

18 MR. KELSEY: The controlling section would  
19 remain 105, and the price that the producer could obtain  
20 under the new successor contract would be two different  
21 answers: one, assuming the Price Protection Act remains  
22 in effect, it would get the maximum the Price Protection  
23 Act allowed. If the price protection act is not in  
24 effect, the producer could then receive for its gas  
25 whatever that former contract would have permitted.



1 whatever its terms would have called for subject to the  
2 federal maximum.

3 QUESTION: Um-hmm.

4 MR. KELSEY: If, as I started out by saying,  
5 the contract expired by its own terms and it were a  
6 rollover contract, the maximum price the producer could  
7 then receive under the terms of Section 106 would be the  
8 price being paid during the month in which that contract  
9 terminated by its own terms. That would be the ceiling.

10 Your Honors, Energy Reserves must overcome the  
11 presumption of constitutional validity to which the  
12 Price Protection Act is entitled. The Kansas Power and  
13 Light Company will address three issues raised by  
14 appellants in this appeal.

15 First, the contracts between the Kansas Power  
16 and Light Company and the appellant have not been  
17 substantially impaired. Energy Reserves is receiving  
18 exactly and precisely what it contracted for. It has no  
19 right to rely on anything other than the price federal  
20 and state law allows. Therefore, the constitutional  
21 inquiry may be ended at this stage.

22 Second, the Price Protection Act serves a  
23 legitimate public purpose, and that is the moderation of  
24 sudden increases in price for a fuel vital to Kansas  
25 agricultural economy and the welfare of its citizens.

1 Energy Reserves has admitted that Kansas may  
2 constitutionally set maximum prices to protect its  
3 consumers. The thrust of Energy Reserves' argument  
4 seems to be its specious claim that the Price Protection  
5 Act is somehow special legislation that benefits the  
6 Kansas Power and Light Company and other gas  
7 distributors. The only beneficiaries of this Price  
8 Protection Act are the approximately two million  
9 consumers of intrastate gas in Kansas who pay, penny for  
10 penny, all costs of the gas they consume.

11 As to the cost of gas paid to producers,  
12 utilities are nothing more than a conduit of dollars  
13 from the consumer to the producer. In fact, for the 12  
14 months ended September 30, 1982, 91 percent of Kansas  
15 Power and Light Company's gas department revenues  
16 amounted solely to gas costs paid to consumers, to  
17 purchasers.

18 Third, the legitimate public purpose of the  
19 Price Protection Act has been achieved on reasonable  
20 conditions which have been appropriately tailored to the  
21 goal with great deference to producers. The Price  
22 Protection Act in fact strikes at 100 percent of the  
23 evil perceived by the legislature by imposing prices  
24 which have been deemed reasonable by the Congress.

25 Energy Reserves' contracts have not been

1 substantially impaired for two specific reasons. It is  
2 receiving exactly what it contracted for, no more and no  
3 less; and that is a price controlled by both state and  
4 federal regulation. Sections 18 and 20 of these gas  
5 supply contracts, respectively, provide that the  
6 contracts are expressly subject to and incorporate all  
7 future state and federal laws. Thus --

8 QUESTION: Well, Mr. Kelsey --

9 MR. KELSEY: Yes.

10 QUESTION: -- Supposing that in the Allied  
11 Structural Steel case the pension contract between  
12 Allied Structural Steel and the pension trustees had  
13 provided that it was subject to all provisions of state  
14 law, or state and federal law -- a provision I think is  
15 probably not uncommon in most contracts. Do you think  
16 that would have resulted in the Allied Structural Steel  
17 case coming out differently?

18 MR. KELSEY: Your Honor, while I think that  
19 this provision is uncommon in gas supply contracts, in  
20 answer to your question I think that the Allied  
21 Structural Steel would have not had an argument that its  
22 contracts had been substantially impaired. It might  
23 well have had other arguments, but it could not have  
24 argued that having incorporated the state law into its  
25 contracts that somehow later than a future state law

1 could impair the terms of that contract which embodied  
2 the law.

3 The Price Protection Act and the --

4 QUESTION: May I ask this question in that  
5 connection? The Kansas Commission approved the  
6 escalation clause initially, did it not?

7 MR. KELSEY: Yes, it did, Your Honor.

8 QUESTION: But under your assumption of what  
9 it could be done, could the Commission now independently  
10 of the federal act change its position with respect to  
11 the escalation clause and hold it null and void, of no  
12 effect?

13 You say that the parties have what they  
14 contracted for because the state reserved the right to  
15 regulate rates, but having approved this clause could  
16 the State of Kansas independently of the federal act  
17 have revoked the escalation right?

18 MR. KELSEY: Yes, I think, Your Honor, the  
19 State of Kansas, either through the legislature or  
20 perhaps through the State Corporation Commission, could  
21 have purported to have declared these clauses null and  
22 void.

23 QUESTION: Well, is there any authority in  
24 Kansas on that point? Can the Supreme Court --

25 MR. KELSEY: For the State Corp --

1 QUESTION: Yes.

2 MR. KELSEY: For the State Corporation  
3 Commission --

4 QUESTION: Yes.

5 MR. KELSEY: -- Dealing with the terms of the  
6 gas contract and declaring them null and void?

7 QUESTION: Yes.

8 MR. KELSEY: No, there isn't, Your Honor, and  
9 in fact, the State Corporation Commission when it  
10 adopted the order which requires the immediate and  
11 automatic pass-through of all natural gas costs paid to  
12 consumers, in Docket Number 106-850 said in April of  
13 1977: "Since energy costs are largely outside the  
14 control of the utility, they ultimately must be passed  
15 through to the consumer, and an appropriately designed  
16 clause is the most efficient method to accomplish this  
17 pass-through."

18 So the Commission has not taken it upon itself  
19 to -- to renegotiate the terms of the contracts between  
20 the parties. These very contracts were the subject of  
21 an extensive hearing in 1975 before the State  
22 Corporation Commission, and the escalator clauses were  
23 inquired into extensively in that hearing. And the  
24 State Corporation Commission authorized the Kansas Power  
25 and Light Company to commence purchases of gas under

1 those contracts, including those terms. So today the  
2 law of the State of Kansas is those terms are approved.

3 Your Honors, it is our position that the  
4 Natural Gas Policy Act and the Price Protection Act are  
5 part of the terms of these contracts. These contracts  
6 were executed in an atmosphere of pervasive regulation  
7 of natural gas by federal and state governments. Kansas  
8 has regulated all aspects of natural gas for more than  
9 75 years. The parties foresaw state and federal law and  
10 regulations and incorporated them into their contracts.  
11 When a contract incorporates state law, that law by  
12 definition is a part of that contract, and the law  
13 cannot impair itself.

14 The second specific reason there's been no  
15 substantial impairment of these contracts is that Energy  
16 Reserves has no right to rely on anything more than  
17 Section 105 of the NGPA, and that is a maximum price  
18 subject to Kansas' right to limit the operation of the  
19 contractual escalator clauses below that maximum price.  
20 The Price Protection Act merely represents Kansas'  
21 exercise of that specific right.

22 Energy Reserves purports to rely on the NGPA  
23 for its claim to higher prices, and yet it claims the  
24 Price Protection Act impaired its contracts. We agree  
25 that the contracts are subject to the Natural Gas Policy



1 Act. We do not agree, however, that Energy Reserves is  
2 subject only to the price limitations of the NGPA it  
3 prefers to the exclusion of other, more stringent  
4 limitations in that act it does not prefer.

5 Prior to the NGPA there were no limitations on  
6 the operation of these indefinite price escalator  
7 clauses in the contracts. The sky was the limit. The  
8 NGPA placed two specific, separate limitations on the  
9 operation of these clauses. First, Section 105 provides  
10 that in no event may escalator clauses operate to  
11 produce a price in excess of the NGPA Section 102  
12 price. But for this limit, Energy Reserves could today  
13 obtain a much higher price for its gas than that Section  
14 102 price.

15 The second limitation intended by Congress in  
16 Section 105 is the specific right of Kansas to prescribe  
17 more stringent limitations on the operation of these  
18 escalator clauses. In response, Kansas, and Oklahoma  
19 for that matter, have prescribed modestly more stringent  
20 limitations on the operation of these clauses. Energy  
21 Reserves has, therefore, no right to cheerfully rely on  
22 and in fact unconditionally demand one price limitation  
23 set by Congress to the exclusion of the other. That  
24 maximum price set by Congress was said to be subject to  
25 Kansas' further limitation on those escalator clauses.

1 Energy Reserves' reliance, therefore, on these contracts  
2 in the NGPA may not exceed the price permitted by both  
3 conditions. Just -- they may not, as they would have  
4 it, just rely on one condition which would permit it the  
5 higher incentive price for its old non-incentive gas.

6 Energy Reserves has no new wells as defined in  
7 the NGPA which provides that higher price for new  
8 wells. This is all old gas wells drilled in the '50s  
9 and '60s primarily. Apparently --

10 QUESTION: And it's also intrastate gas.

11 MR. KELSEY: I'm sorry, Your Honor.

12 QUESTION: It's also intrastate gas.

13 MR. KELSEY: It is indeed intrastate gas  
14 subject to the terms of Section 105 which say the price  
15 of that gas is whatever the price is under the terms of  
16 your contract, but in not more than in excess of Section 102  
17 unless the states further limit the operation of those  
18 escalator clauses.

19 QUESTION: Well, are you saying, in effect,  
20 that even had Congress not passed this statute, which  
21 seems to be the subject of most of the discussion of the  
22 case, that Energy Reserves would be in no better  
23 position?

24 MR. KELSEY: Even if --

25 QUESTION: Or say in no worse position?



1 MR. KELSEY: Even if Congress had not passed  
2 the statute?

3 QUESTION: If the Kansas legislature hadn't  
4 passed the statute.

5 MR. KELSEY: If the Kansas legislature had not  
6 passed the statute, then in 1981 in November Energy  
7 Reserves' contract under its price redetermination  
8 escalator clause that Mr. Davis referred to, its price  
9 would have been redetermined to a maximum price of that  
10 Section 102 price provided Energy Reserves could have  
11 produced three contracts that -- in the area that were  
12 comparable and met the terms of the contracts that were  
13 calling for that price, that were receiving prices.

14 So, in fact, in November of 1981 there was a  
15 price redetermination under these contracts. There has  
16 been a price increase since --

17 QUESTION: Are you saying that the Kansas  
18 statute had no effect on what Energy Reserves was  
19 entitled to receive?

20 MR. KELSEY: It had no effect on what they  
21 were entitled to receive for the reason that I  
22 mentioned. It is only entitled to receive what the  
23 state law allows it.

24 In specific response to Your Honor's question,  
25 it is receiving less in all likelihood than it would

1 have been receiving had the Price Protection Act not  
2 been passed. In all likelihood it would today be  
3 receiving the NGPA Section 102 price for November of  
4 1981 because these redeterminations occur every two  
5 years.

6 But instead, in 1981 in November, of  
7 redetermining to that higher 102 price, the parties met,  
8 and as the Price Protection Act permits, redetermined to  
9 that NGPA Section 109 price.

10 QUESTION: I thought the 102 applied to new  
11 gas.

12 MR. KELSEY: 102 does apply to new gas, Your  
13 Honor, under the NGPA.

14 QUESTION: But this is old gas.

15 MR. KELSEY: It is old gas, that is correct.  
16 And therein lies the sense of the structure of Section  
17 105(b)(1) of the Natural Gas Policy Act. In the  
18 intrastate market there were various prices being paid  
19 in the gas-producing states, none of them regulated by  
20 the states. There were high prices being paid in  
21 Texas. We have contracts as low as 25 cents per MCA.

22 Congress simply said the terms of those  
23 contracts are the price -- is the price that you should  
24 be paid. There were some escalator clauses in those  
25 contracts, and so Congress said but in no event may

1 those escalator clauses carry you above Section 102; the  
2 new gas price is an absolute maximum.

3 QUESTION: I see. I see.

4 QUESTION: Well, isn't your theory quite  
5 different from that of the Kansas Supreme Court?

6 MR. KELSEY: On the --

7 QUESTION: Isn't the theory you're now arguing  
8 different from that in which the Kansas Supreme Court  
9 upheld the act, the Kansas act?

10 MR. KELSEY: I don't think so, Your Honor.  
11 The Kansas Supreme Court addressed itself to the  
12 appropriateness of the terms and the fact that the  
13 statute was directed to a public purpose and the like.

14 QUESTION: Yeah, but the Kansas Supreme Court  
15 obviously felt obligated to deal with the Energy  
16 Reserves claim of impairment of contract obligation, and  
17 it didn't go off on the ground that you now urge that we  
18 do, that the contract had a provision that said it would  
19 be subject to all state law. It went through a  
20 constitutional analysis. I understand from your  
21 argument that that really isn't necessary.

22 MR. KELSEY: Your Honor, under the case of  
23 United States Mortgage v. Matthews it's our  
24 understanding that this Court is the court the  
25 determines the requirements for applying the

1 constitutional test under the contract clause. And as  
2 Allied Structural Steel indicated, if there is no  
3 substantial impairment, the inquiry may be ended.

4 In summary, Energy Reserves is receiving  
5 everything it contracted for at a price permitted by  
6 state and federal law, and having received its  
7 legitimate contractual expectations, the contract  
8 inquiry -- the contract clause inquiry may be ended.

9 QUESTION: What about their argument that  
10 they've lost their right to terminate?

11 MR. KELSEY: Your Honor, the right to  
12 terminate is specifically conditioned in the contract on  
13 an increased price. Absent an increased price, there is  
14 no right to terminate. It's as clear and simple as that.

15 QUESTION: You mean a contractually allowed  
16 increased price.

17 MR. KELSEY: Yes.

18 QUESTION: And you're saying the contract  
19 wouldn't allow an increased price because the state law  
20 was to the contrary.

21 MR. KELSEY: Exactly, Your Honor. As well as  
22 the federal law above 102.

23 QUESTION: 102, yeah.

24 MR. KELSEY: Kansas' right to set natural gas  
25 prices is without question. Natural gas is a vital fuel

1 to Kansas. Seventy-five percent of the homes are heated  
2 with gas. It is the single most important fuel for  
3 irrigation pumping and fertilizer production.

4 Energy Reserves admits that Kansas may set  
5 maximum prices for all natural gas to protect its  
6 customers, its consumers. This inquiry -- this  
7 admission should end the constitutional inquiry of  
8 public purpose, because the Price Protection Act was  
9 intended to and it has the effect of regulating the  
10 price to consumers of natural gas produced and consumed  
11 in Kansas.

12 Energy Reserves purports to make, however, an  
13 argument that the Price Protection Act somehow benefits  
14 the Kansas Power and Light Company. The state  
15 legislature's conclusions and orders of the State  
16 Corporation Commission, as I have indicated, completely  
17 belie that conclusion. As the legislature knew and  
18 concluded when it enacted this law, utilities cannot  
19 benefit economically by an increased or decreased cost  
20 of gas. That was the testimony of the chairman of the  
21 State Corporation Commission to the legislation. And as  
22 I've indicated, we are serving -- we are buying gas  
23 under these contracts pursuant to the Commission's  
24 approval of these pricing clauses. We are passing  
25 through in 1981 \$137 million of purchased gas cost to

1 producers without adding one shred of interest on the  
2 utility's part. Ninety-one percent of our revenues from  
3 gas operations are merely purchased gas costs.

4           The legislature, the trial court, and the  
5 Kansas Supreme Court all concluded that but for the  
6 Price Protection Act, Kansas consumers would pay the  
7 higher new gas costs for the old gas they were using.  
8 The legislature further concluded that absent the Price  
9 Protection Act, the burden of increased costs will be  
10 passed on to consumers, and that savings to those  
11 consumers is ample reason to support the act.

12           The presence of the State Corporation  
13 Commission, the Kansas Legal Services representing  
14 persons of low income in Kansas in amici briefs to the  
15 court confirmed that the \$128 million in gas cost  
16 reductions wrought by this law will be received only by  
17 the two million persons of the -- 2,400,000 people in  
18 the state.

19           QUESTION: Mr. Kelsey, what justification is  
20 there for the Kansas statute to allow increases under  
21 these indefinite escalator clauses for old intrastate  
22 gas in contracts executed after April 20, 1977 but not  
23 for contracts executed before that date?

24           MR. KELSEY: Two specific answers, Your  
25 Honor. First, the legislature perceived that for those



1 persons who had intrastate gas to sell and who entered  
2 into them after that date, April 20, 1977, when the  
3 President announced the national energy plan, the  
4 legislature perceived that those persons might have some  
5 greater right to rely on a higher price for their gas.

6 QUESTION: Based on the President's speech.

7 MR. KELSEY: Yes. On the announcement of that  
8 national energy plan.

9 Secondly, if the act covered contracts  
10 executed after that date and into the future, producers  
11 of intrastate gas in Kansas who had gas to sell could  
12 conceivably receive a higher price in the interstate  
13 market for that gas, and it would tend to diminish the  
14 availability of gas in Kansas.

15 Your Honors, Energy Reserves has complained  
16 that the terms and conditions of this statute are  
17 unreasonably narrow. Kansas' goal of moderating gas  
18 price increases has been achieved on very reasonable  
19 conditions, carefully tailored to the goal, with  
20 extraordinary deference to these very producers. Of all  
21 the gas being consumed in Kansas, only intrastate gas  
22 subject to escalator clauses had the potential for  
23 sudden increases which concerned the legislature. The  
24 Price Protection Act reaches 100 percent of that gas.  
25 Yet, Energy Reserves complains that the Price Protection

1 Act reaches an insufficient volume of gas; Mr. Davis  
2 says 10 percent of the gas, intrastate gas consumed in  
3 Kansas.

4 The facts are that 75 percent of all the gas  
5 consumed in Kansas is interstate in origin and beyond  
6 the reach of the legislature. Moreover, all that  
7 interstate gas is priced, as a result of the NGPA, at or  
8 lower than, much lower than in many instances, the  
9 maximum price set by Kansas for intrastate gas.

10 Sixty percent of the gas consumed in Kansas  
11 which is produced in Kansas is not subject to these  
12 escalator clauses. Mr. Davis indicated that fixed price  
13 escalator clauses could take the price over 102, and  
14 therefore the statute was narrow.

15 The only contracts before the legislature when  
16 it considered this legislation were contracts with fixed  
17 price escalator clauses of one or two cents a year, one  
18 percent a year. Obviously, when we're talking about  
19 kinds of increases permitted here, they could never  
20 reach the Section 102 price.

21 Moreover, the Natural Gas Policy Act itself in  
22 Section 105 has the effect of limiting the price for  
23 that intrastate gas not subject to escalator clauses in  
24 affect freezing the price to what was being received in  
25 real terms on the day the act became a law.



1           So it's only 40 percent of the gas consumed in  
2 Kansas that's produced in Kansas which was subject to  
3 escalator clauses where the legislature perceived the  
4 evil of sudden increases in price. Therefore, the  
5 Kansas legislature regulated that, and it regulated 100  
6 percent of that evil. And it did so on very reasonable  
7 terms, adopting the pricing scheme of the NGPA.

8           It did so by saying for old non-incentive gas,  
9 such as the gas under these contracts, we will allow the  
10 maximum price if your contracts otherwise call for it --  
11 the NGPA 109 price, which happens to be the very same  
12 price as the maximum price for old interstate gas as set  
13 in Section 104. It did so by saying but for your new  
14 gas, any wells the surface drilling of which was  
15 commenced on and after February 19, 1977, your contract  
16 clauses may escalate the price for that new gas on up to  
17 that NGPA Section 102 ceiling in order to encourage  
18 exploration. No change.

19           It further said and moreover, for low  
20 production or stripper well gas, as defined in the NGPA  
21 in Section 103, the Price Protection Act will allow  
22 Kansas intrastate producers that very same maximum gas  
23 if your contract calls for it.

24           As Energy Reserves concedes, Kansas has the  
25 constitutional authority to set maximum prices.

1 Therefore, we submit, the Price Protection Act's much  
2 less stringent limitations on prices are  
3 constitutional. The legislature was merely deferring to  
4 the producers' interest in achieving its goal.

5 Energy Reserves has in fact described the  
6 economic policy of the NGPA as reasonable, but when that  
7 policy is applied by the Kansas legislature to its  
8 contracts, it complains that the scheme is  
9 unconstitutionally narrow and constitutes special  
10 legislation.

11 The Kansas legislature limited sudden price  
12 increases --

13 QUESTION: Well, the complaint is that it  
14 violates a specific provision of the Constitution  
15 limiting state authority.

16 MR. KELSEY: And I'm -- and I'm addressing my  
17 comments, Your Honor, to if there is in fact a  
18 substantial impairment, which we think there is not,  
19 that the goal was a clearly legitimate one, as the  
20 NGPA's very goal was of limiting sudden price increases  
21 for old gas, because it froze the price of old  
22 interstate gas.

23 QUESTION: Well, that just turns the contract  
24 clause into a due process limitation.

25 MR. KELSEY: It meets the -- I'm speaking to

1 the reasonableness with which the state legislature  
2 sought to achieve that proper public purpose. It  
3 tailored a pricing system. It reached all the gas it  
4 could reach. It's of no benefit, none whatsoever, to  
5 the Kansas Power and Light Company.

6 Your Honors, if the Price -- if the contract  
7 clause has any flexibility when vital interests are  
8 served, as Energy Reserves concedes in its reply brief  
9 that it must, a major gas-producing state such as Kansas  
10 may impose modest and temporary restrictions on sudden  
11 increases in price for natural resource fuel it has  
12 regulated for 75 years.

13 Natural gas is absolutely essential to the  
14 health and welfare of Kansas people, as well as to the  
15 principal industry of the state, and that's  
16 agriculture. This position is particularly true when  
17 the suppliers of that essential commodity specifically  
18 made those state restrictions a part of the contract  
19 price terms and when the pricing system embodied in  
20 those restrictions is one that Congress has found as  
21 reasonable.

22 Thank you.

23 CHIEF JUSTICE BURGER: Do you have anything  
24 further, Mr. Davis?

25 ORAL ARGUMENT OF GARY W. DAVIS, ESQ.,

1 ON BEHALF OF THE APPELLANT -- REBUTTAL

2 MR. DAVIS: I just want to make a few points,  
3 Your Honor.

4 First off, this is the first time I've ever  
5 heard this argument that the Section 105 and the Section  
6 102 price is anything different.

7 Secondly, there is -- until this moment I  
8 thought there was no argument that our contracts have  
9 been impaired. Looking at page 23A of the Appendix to  
10 the Jurisdictional Statement, which is the Supreme Court  
11 of Kansas decision, it says, "The statute obviously was  
12 intended to and does impair the rights of ERG under the  
13 contracts."

14 With regard to this applicable laws provision  
15 that Mr. Kelsey has talked about, first off, that is a  
16 standard provision that you see in almost every  
17 contract. Secondly, I see no way that it can  
18 possibly be construed to mean that it means that it's  
19 subject to invalid state laws. And furthermore, as just  
20 a last point on the intent of the parties under that  
21 applicable laws provision, there is the last sentence  
22 that says, "In effect, notwithstanding any such  
23 applicable laws, such applicable laws shall not prevent  
24 Energy Reserves from exercising its right of termination  
25 if it did not receive the price increases promised by

1 these two price escalation provisions."

2 The other provision, throughout this case KP&L  
3 has tried to picture itself as a benevolent  
4 institution. In the testimony in which they were  
5 justifying these contracts before the Kansas Corporation  
6 Commission, their vice president and a member of their  
7 Board of Directors testified at length. He testified  
8 that if KP&L was not entitled to enter into these  
9 contracts that they would lose the value of their  
10 investment of \$3,600,000 because they would lose the  
11 value of the gas-gathering facilities. To say that they  
12 don't have a financial interest is ridiculous.

13 Secondly, KP&L doesn't think themselves  
14 that they have a right to pass this through. When the  
15 price increase was triggered in 1978, what'd they do?  
16 They applied to the Kansas Corporation Commission for  
17 permission to pass it through. They did the same thing  
18 in February of 1979. And they know as well as I do that  
19 these price increases are in nowise automatic.

20 I would simply -- I would ask the Court to do  
21 one other thing, and that is to look at 55-1408. We  
22 call it the Section 8 of the act. What that act  
23 authorizes the parties to do is to renegotiate the price  
24 provisions to any price they want up to the legal  
25 ceiling. Obviously, Energy Reserves wants the price

1 that it contracted to receive. What that means is that  
2 the Kansas legislature has delegated to Kansas Power and  
3 Light the power and authority to totally avoid all of  
4 the price limitations that are contained in this Kansas  
5 act. They've turned a bilateral contract into a totally  
6 unilateral contract.

7 Thank you.

8 CHIEF JUSTICE BURGER: Thank you, gentlemen.

9 The case is submitted.

10 (Whereupon, at 1:42 p.m., the case in the  
11 above-entitled matter was submitted.)  
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CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:

ENERGY RESERVES GROUP, INC., v. THE KANSAS POWER AND LIGHT COMPANY  
#81-1370

and that these attached pages constitute the original transcript of the proceedings for the records of the court.

BY

Pine Hammel

(REPORTER)

