ECONOMIC MAKE-BELIEVE IN THE SUPREME COURT

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Roe v. Wade has done more than legalize abortions and become a talisman for the ideological packing of the federal judiciary. It has resulted in the death of tree after tree, all in the cause of more and better constitutional theory. Whatever the initial interest, over time the outpouring has grown very stale. Thus when Laurence Tribe's new book, *Constitutional Choices*, devoted its preface and first two chapters to blasting theory, my heart grew warm. Maybe more constitutional writing will turn away from jurisprudence and back to reality. A nice starting point might be the facts of the cases, because it is the facts—reality, if you will—that give constitutional law its force.

As a small contribution, I wish to discuss two recent and obscure decisions: *Energy Reserves Group (ERG) v. Kansas Power & Light (KPL)*[1] and *Hawaiian Housing Authority v. Midkiff*.[2] Both decisions were unanimous, bringing together Justices Brennan and Rehnquist and everyone in between. This perhaps helps to explain their obscurity. Unanimous decisions are unlikely to have either the factual or legal complexity of most of the Court's work. Or so we may think. But in each of these cases the opinion contains a telltale sign that something was amiss. When the Court offers such hints, we ought to take a close look at what is happening.

ERG contains the following sentence: "Although prices in the intrastate market have diverged somewhat from those in the interstate market due to the recent shortage of natural gas, the regulation of interstate prices effectively limits intrastate price increases."[3]

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1. 459 U.S. 400 (1983). (Justice Powell wrote a two paragraph concurring opinion joined by the Chief and Justice Rehnquist to indicate that one section of the Court's opinion was unnecessary to the judgment and that he would leave that problem for another day. All three joined the parts of *ERG* that I will discuss.) I should add that I was losing counsel on a petition for certiorari in Mesa Petroleum v. KPL, 455 U.S. 928 (1982), a case presenting an identical federal statutory issue to the one in *ERG*. The statutory issue is not pertinent here. *Mesa* lacked the constitutional issue.

2. 104 S. Ct. 2321 (1984). (Justice Marshall did not participate.)

3. *ERG*, 459 U.S. at 414.

When the Justices conclude that artificially holding down the price in one market will, during shortages, also hold down the price in a free market, then the reader suspects that the Court is going to commit ignorance—maybe worse.

In *Midkiff* the sign was less obvious: instead of identifying the plaintiff, the Court simply referred to "appellees" without further description.[4] Because most cases have real plaintiffs, it is worth looking in the briefs or the opinions below to find out who they are. What you discover may surprise you.

I

After Congress passed the Natural Gas Policy Act of 1978 (NGPA), Kansas accepted a statutory invitation to slap price controls on sales of intrastate gas in circumstances where the price would otherwise escalate because of the NGPA. KPL and ERG had negotiated a contract in 1975 containing escalation clauses that were triggered by the NGPA. The Kansas statute thus blocked a previously agreed-upon price increase.

The Court easily sustained the Kansas statute against a contract clause challenge. The Justices saw no substantial impairment of the parties' contractual obligations. First, the Court found that Kansas was not adopting "special interest" legislation because the statute affected the natural gas industry generally, not just one or two firms. Further, the Kansas statute was prompted by "significant and legitimate state interests": the need to protect consumers from rapidly rising natural gas prices "caused" by congressional deregulation.[5] Second, and more important, there was no disruption of expectations since no one in the industry could have anticipated federal deregulation.[6]

The key to *ERG* is the Court's conclusion that the price increase called for by the contract would create "unforeseen windfall profits."[7] How does application of a contract create a "windfall"? The Court did not think to ask. Nor did it examine the purpose of the price escalation clause. If one searches for answers to these questions the case becomes more interesting—and also more difficult.

Natural gas contracts are "long-term," often for the life of the

4. Even the style of the three consolidated cases gives no hint who the plaintiff-appellees are. All three are "v. Frank E. Midkiff et al." *Midkiff*, *supra* note 2.

5. *ERG*, 459 U.S. at 416-18 & n.25. This flows from Allied Structural Steel v. Spannaus, 438 U.S. 234 (1978).

6. *ERG*, 459 U.S. at 415-16. This criterion comes from the other recent contract clause decision, United States Trust v. New Jersey, 431 U.S. 1 (1977).

7. *ERG*, 459 U.S. at 412.

well.[8] Producers like Energy Reserves Group must have continuous production to maintain their leases and need an income stream to meet financial commitments attendant to drilling. Purchasers like Kansas Power & Light need to cover the cost of any necessary pipeline construction as well as know there will be consistent supplies so that they do not lack energy at a crucial time. Yet in inflationary times no producer wants to agree to a long-term, specific, fixed price.[9] Hence natural gas contracts contain escalation clauses to cover the eventualities that will almost undoubtedly occur during a long-term relationship.[10]

The contract in *ERG* fit this pattern perfectly. KPL wanted a life-of-the-field contract[11] and yet it offered less money than others for ERG's gas.[12] ERG's need, however, was for inflation hedges during a time of rapidly increasing prices. The result of the difficult arms length bargaining[13] was that KPL got its life-of-the-field provision as well as lower initial prices. But in turn KPL yielded two price escalators to ERG.[14]

The function of a price escalator clause is to provide for price

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8. "One of the cardinal principles of a gas sales contract is that it must be 'long term.' " Johnson, *Natural Gas Sales Contracts*, 34 INST. ON OIL & GAS L. & TAX'N 83, 95 (1983). But most such contracts terminate automatically if production in paying quantities ceases.

9. Of course the initial price could be set quite high in order to allow for future inflation. In the 1950's prices were higher for long term contracts, but contracts with escalators had significantly lower prices than those without them. P. MACAVOY, PRICE FORMATION IN NATURAL GAS FIELDS 237 (1962).

10. *See* Cassin, *Gas Purchase Contracts—Enticing a Shy Genie from an Invisible Lamp*, 25 INST. ON OIL & GAS L. & TAX'N 27 (1974); Crump, *Natural Gas Price Escalation Clauses: A Legal and Economic Analysis*, 70 MINN. L. REV. 61, 63-68 (1985). Between 1961 and 1978 indefinite price escalation clauses were prohibited in contracts subject to Federal Power Commission (and then Federal Energy Regulatory Commission) jurisdiction, that is interstate contracts. "Even these contracts, however, frequently contained a 'deregulation clause,' which provided for the operation of an indefinite pricing clause should the gas covered by the contract ever be deregulated." Johnson, *supra* note 8, at 94 & n.52 (1983).

11. KPL's Executive Vice President testified in November, 1975 before the Kansas Corporation Commission that the contracts "certainly" were "the result of arm's length negotiations." A life-of-the-field contract was "necessary to meet the demands of [KPL's] present customers." Reproduced in Appendix to Appellant's Reply Brief at 9a, *ERG*, *supra* note 1.

12. Appellant's Brief at 3-4, *ERG*, *supra* note 1.

13. KPL's Executive President testified that the negotiations were "the longest and most complicated of anything we have ever been involved in." Testimony, *supra* note 11 at 3a.

14. In response to the question whether the escalator clauses were a quid pro quo for the life of the field clause, KPL's Executive Vice President stated: "That's correct. I think that is a distinct advantage to both parties is this situation and certainly one that was considered in the negotiations." Testimony, *supra* note 11, at 9a. This is hardly uncommon. Parties often trade future price increases for the elimination or addition of certain contract clauses and these trades are "as much a part of the total consideration" as the initial contract price. E. NEUNER, THE NATURAL GAS INDUSTRY: MONOPOLY AND COMPETITION IN FIELD MARKETS 266-69 (1960).

increases should a specified event occur. The event that occurred in *ERG* was deregulation. By 1975, when the contract was drafted, producers were certain that the Natural Gas Act of 1938 could not last. One possibility was that Congress would apply price controls to intrastate gas,[15] thereby removing the incentive of producers to avoid federal control by selling intrastate.[16] The other possible change was in the opposite direction—deregulation of interstate prices.[17] Apparently the members of the United States Supreme Court could not see that their ever-tightening regulatory holdings,[18] when combined with shortages[19] and a decrease in the available reserves of natural gas,[20] would produce a fundamental change in the Natural Gas Act—with a strong possibility of deregulation. Not everyone was equally ignorant.[21] The clause in the ERG-KPL contract was inserted precisely because ERG foresaw the possibility of deregulation. The Court's statement about what the parties could anticipate was flatly wrong.[22] Needless to add, no citation to the record accompanied it.

Still, the Court offered the consolation that the statute was not

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15. Cassin, *supra* note 10, at 59. In a section entitled "The Prospect for Deregulation," Cassin notes that bills extending federal regulation of intrastate gas had been introduced in Congress.

16. Since intrastate prices were not regulated and interstate prices were, newly discovered gas remained in the intrastate market thereby exacerbating the reserves problem for consumer states. See Braeutigam, *The Deregulation of Natural Gas*, in CASE STUDIES IN REGULATION: REGULATION AND REFORM 142, 156 (L. Weiss & M. Klass eds. 1981).

17. Amazingly, the NGPA combined both features. The Senate bill had looked to deregulation, the House bill to tighten regulation. The Conference Committee pasted the two together. Note, *Legislative History of the Natural Gas Policy Act: Title I*, 59 TEX. L. REV. 101 (1980).

18. *See* H. WILLIAMS, R. MAXWELL, & C. MEYERS, CASES AND MATERIALS ON THE LAW OF OIL AND GAS 42-59 (4th ed. 1979).

19. Crump, *supra* note 10, at 63: "During the 1970's, when natural gas shortages produced layoffs, plant closings, hardships, and even deaths, it became clear to all informed observers that the market price of gas would rise." (Footnotes omitted.)

20. *See* Table 1 in MacAvoy, *The Natural Gas Policy Act of 1978*, 19 NAT. RES. J. 811, 816 (1979) (gas reserves falling every year after 1970).

21. As early as 1970 the Fifth Circuit had concluded that Federal Power Commission pricing policy, constrained by decision after decision of the Supreme Court, was "whistling in the dark." Southern Louisiana Area Rate Cases v. Federal Power Commission, 428 F.2d 407, 415-18, 444 (5th Cir. 1970).

22. Watson, *The Natural Gas Policy Act of 1978 and Gas Purchase Contracts*, 27B ROCKY MTN. MIN. L. INST. 1407, 1418-21 (1982) (discussing the evolution of area rate escalators). When I was preparing the certiorari petition for *Mesa, supra* note 1, Mesa's local counsel told me that he could tell when a contract was drafted by the types of clauses that appeared in it, and that by the mid-70's producers could see the possibility of deregulation. For an interesting confirmation, see M. LAIRD, ENERGY—A CRISIS IN PUBLICI POLICY 6 (1977): "[B]ecause natural gas deregulation legislation has narrowly failed in Congress in the last two years, producers have probably been watching Washington more carefully than their geological studies in deciding when and where to explore for new supplies." *See also* note 10 *supra*.

"special interest" legislation. Its reach included all producers in Kansas who sold their gas in the local market. Presumably these producers can hold their own in the legislature against those Kansans who would complain about high electric bills during a time of spiralling inflation. Whether the statute worked to hold consumer bills down significantly may be problematical; that it took from the producers to give to the consumers is not.

II

As readers of James Michener's *Hawaii* are aware, prior to American acquisition Hawaii had developed a feudal land ownership system which has proven remarkably resistant to change. The largest eighteen landholders (each with holdings of over 21,000 acres) in the state own 40% of the land. The seventy-two largest landowners own 47%, and since the state and federal governments own 49%, little is left for the rest of the population. On Oahu, where the vast majority of the state's people live, the twenty-two largest landowners control 72.5% of all private land.[23]

In order to break up this feudal pattern, the state legislature passed the Land Reform Act of 1967. The act created a statutory mechanism for condemning residential tracts at the behest of the homeowner-lessee and transferring the fee title to the lessee, with compensation to the former owner. This, said the Supreme Court, would end an oligopoly the state legislature had decided was "responsible for skewing the State's residential fee simple market, inflating land prices, and injuring the public tranquility and welfare."[24] The Bishop Estate, on whose behalf the Land Reform Act was challenged, was the biggest landowner of all, owning 22% of all private land on Oahu.[25]

The fifth and fourteenth amendments prohibit taking of private property for public purposes without just compensation; and the Court has held that they implicitly prohibit *any* governmental taking of private land for a *private* purpose. The legal issue in *Midkiff* was whether Hawaii's use of condemnation on behalf of private parties was a "private" use and therefore unconstitutional despite the statutory provision for compensation. The issue was neither novel nor unsettled. In 1954 *Berman v. Parker*[26] had upheld urban re-

23. *Midkiff*, 104 S. Ct. at 2325; the Hou Hawaiians and Maui Loa, Chief of the Hou Hawaiians Amicus Brief at 32-33; Queen Liliuokalani Trust, King Lunalilo Trust, Alu Like, Inc. and Association of Hawaii Civic Clubs Amicus Brief at 19.

24. *Midkiff*, 104 S. Ct. at 2325.

25. Brief for Appellants, Jurisdictional Statement at 1, Midkiff, *supra* note 2.

26. 348 U.S. 26 (1954).

newal in the District of Columbia against a similar attack. In *Berman* the government was trying to eradicate slums; in *Midkiff* it had the equally noble-sounding purpose of eradicating feudalism. Predictably, the Court unanimously held that condemning private land under the Land Reform Act was not a "purely private taking" and "not to benefit a particular class of identifiable individuals."[27]

The quoted language resembles *ERG*'s conclusion that no special interest legislation was involved. But all Kansans use natural gas in one way or another, while not all the citizens of Hawaii were beneficiaries of the land redistribution plan. By the very terms of the act, *Midkiff* involved homeowners who wished to be landowners, or in other words only those who could afford to buy a house in what all admit is a tight and expensive market. They may not be "a particular class of individuals," but the Islands' underprivileged they are not. In fact they are the middle class whites and Japanese who dominate Hawaiian politics. *Midkiff* consisted of three consolidated cases and the landowners specifically involved came from an area of Eastern Honolulu where according to census figures the average household income was a whopping $42,000.[28]

So it looks like a fair fight. The middle class against Hawaii's elite, the five families: Alexanders, Baldwins, Castles, Cookes, and Davies. If the former rulers lose to the newcomers, that's politics. It does not look like a case for judicial intervention.

But our tidy legal pigeonholes conceal important complexities. As I mentioned, and the Court did not, the plaintiffs were suing on behalf of the Bishop Estate. Bernice Pauahi Bishop, the last lineal descendant of King Kamehameha the Great, established the Bishop Estate in her will. The Estate is preserved as a perpetual educational trust for the support of descendants of the original Hawaiians. The income of the Bishop Estate comes from but 3% of the land it holds, the remainder having no current commercial value.[29]

That the 175,000 citizens of Hawaiin ancestry could use help jumps out from any look at the pertinent statistics.[30] The median income from Chinese households is over $21,000. For both whites and Japanese it is over $19,000. For those with some Hawaiian ancestry it is $13,000 and for pure Hawaiians it's under $9,300. Not surprisingly, behind these figures are others showing that Hawaiian

27. *Midkiff*, 104 S. Ct. at 2331.

28. Queen Liliuokalani Trust Amicus Brief, *supra* note 23, at 17.

29. *Id.* at 5. Two-thirds of the income producing property is in residential leases; the rest is leased to commercial establishments.

30. Office of Hawaiian Affairs Amicus Brief at 18, 20. The Office of Hawaiian Affairs is a government agency created by the state constitution. Its brief supported the Bishop Estate.

employment is overwhelmingly blue collar; fewer than half graduate from high school and less than 5% from college; and their life expectancy is the lowest of any group in the Islands. The Bishop Estate may not have been helping much, but it was at least trying to help where help was most needed.

In this context, the Land Reform Act of 1967 turns out to be a statute well-suited for Footnote Four analysis, inasmuch as it takes from those who have least and gives to those who have most. Not so, argue those supporting the law, who portray it as a general law, applicable to all large landowners, not only the Bishop Estate. Beneficiaries of the law include the less wealthy as well as the affluent. And—most significantly—the Bishop Estate, like others whose land is taken, will receive just compensation.

The claim of general applicability is true and indeed the strongest part of the case. The Land Reform Act does apply to all large landowners. Yet what fueled the land reform was the residential leasing in Honolulu. The Bishop Estate was the only great landowner involved in that leasing. Some smaller landowners were also involved, but they did not fight; only the Bishop Estate did. The Kahala lessees attempted to deflect notice from the rather handsome incomes in Eastern Honolulu where they reside by noting that one of the three cases before the Court—the named case in fact—involved the Bishop Estate's holdings in Western Honolulu where the mean household income "was only $23,332."[31] A far cry below Kahala. But a far cry above the largely landless native Hawaiians.

This leaves us with the issue of compensation. Since the Estate will get "just compensation," the casual observer may suppose it will be no worse off than if it still owned the land and received ground rents monthly. But then why did the Estate enrich so many local and mainland lawyers on the way to defeat in the Supreme Court?

The easiest way to answer this question is by posing a variant of the contingent fee question we put to students and colleagues: which side would you want to take on a contingent fee basis? Here the question is which would you rather have: (1) the right to a monthly ground rent in perpetuity where the rent is renegotiated every few decades to reflect changes in market value or (2) the current value of the fee remainder at the end of its current long term lease (negotiated in the 1940's and 1950's and reflecting then prevailing market values)—as determined by a judge and jury? In answering this question, bear in mind that the Hawaiian judiciary is

31. Appellant's Reply Brief at 16 n.16, Kahala Community Association v. Midkiff, 104 S. Ct. 2321 (1984).

one of the most politicized in America. Consider also that few if any native Hawaiians will be on the jury; indeed, the jury is likely to be composed of people drawn from the same middle class as the condemnor.

The landowner is likely to get much less than the market would have provided. The Kahala lessees were remarkably candid on this point. Addressing the difference in compensation under the act and without the act, they stated that given the "lessees' strong desire to own the land under their homes," without eminent domain the Bishop Estate would receive "prices much higher than the fair market value that would be received by condemnation pursuant to the Act."[32] And if the lessees did have to pay the higher price it might set off "a social revolution that would irreparably damage [the] Bishop Estate and its beneficiaries."[33]

One could not ask for more candor from a party. They said what they wanted: land. They said how much they wished to pay: less than negotiations with the owner would require. And they said what would happen if they could not have their way: the small number of native Hawaiians would be in for hard times.

Midkiff is a reverse Robin Hood case. As the lessees argued, there could be no "financial killing at the expense of Hawaii's middle class."[34] The "financial killing" will instead be at the expense of the Hawaiians (unless, of course, one wishes to ignore the Bishop Estate or assume—as the Kahala homeowners did not—that compensation awards will leave the condemnee whole). It is true that *Midkiff* involved only the public use and not the just compensation issue, which theoretically could still be resolved fairly. But does anyone believe the United States Supreme Court has the time, energy, or will to police the compensation awards in the thousands of eminent domain proceedings that will occur?

III

The results in *ERG* and *Midkiff* are not particularly surprising. Any Court-watcher could have predicted that the Justices would not provide constitutional protection for potentially massive natural gas price increases. Nor was the Court likely to back away from *Berman v. Parker*. With the outcomes virtually foreordained, the interesting question was what the opinions would say. In *ERG* how

32. *Id.* at 29-30. Laurence Tribe was retained to represent the State of Hawaii and was prevailing counsel. He did not represent the Kahala homeowners and obviously did not write the brief I am quoting.

33. *Id.* at 31-32.

34. *Id.* at 31.

would the Court arrive at the conclusion that obliteration of a contract's most significant provision is not a substantial impairment? And in *Midkiff* how would the victory of the middle class be portrayed?

In *ERG* the Court simply refused to look at the economics of a market transaction. Probably it was transfixed by the assumption that any price increase to an energy producer must be a windfall—by definition. Since the increase would be a windfall, it could not have been anticipated. Therefore, despite the bargaining of the parties and the escalators in the contract, it has not been anticipated. Or maybe the Court was simply unwilling to budge from its position, maintained for three decades, that natural gas prices should not rise.[35]

Midkiff is different because the Court must have known who the plaintiff was. But it did not inform anyone else. On its facts the case is a solid win for formalism over reality. It could hardly have been otherwise; given the Court's reluctance to find a forbidden "private" purpose behind reallocations of wealth, the facts are largely irrelevant.

Unpleasant facts versus soothing presumptions: this is a battle that never ends in the Supreme Court. Examples abound. In cases about police brutality toward minorities, most of the Justices refused to concede what everyone knew.[36] Juvenile justice,[37] criminal procedure,[38] habeas,[39] welfare cases,[40] Southern justice in the 1960's[41]—almost everywhere the same conflict exists between a judicial system that formalistically declares certain facts irrelevant and one where judges are interested in social reality.

Returning to where I started, maybe various constitutional theories can make these two decisions more acceptable. But I have my doubts. In any event, digging into a record and looking at the facts of the cases enriches our understanding of constitutional adjudication. For my part I'd like to see more of it in the pages of our journals.

35. *See* Williams, *supra* note 18.

36. City of Los Angeles v. Lyons, 461 U.S. 95 (1983) and Rizzo v. Goode, 423 U.S. 362 (1976) (police misconduct).

37. In re Gault, 387 U.S. 1 (1967) (juvenile court as neutral friend of the child).

38. Miranda v. Arizona, 384 U.S. 436 (1966) (equality of treatment of rich and poor).

39. Wainwright v. Sykes, 433 U.S. 72 (1977); Estelle v. Williams, 425 U.S. 501 (1976) (competency of counsel who fails to make an obvious motion).

40. Wyman v. James, 400 U.S. 309 (1971) (welfare workers as presumptively interested in clients).

41. Walker v. City of Birmingham, 388 U.S. 307 (1967); City of Greenwood v. Peacock, 384 U.S. 808 (1966); Dombrowski v. Pfister, 380 U.S. 479 (1965).