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The Takings Clause: A Protection to Private Property Rights in Federal Oil and Gas Leases

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THE TAKINGS CLAUSE: A PROTECTION TO PRIVATE PROPERTY RIGHTS IN FEDERAL OIL AND GAS LEASES*

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I. INTRODUCTION

The petroleum industry locates and produces the oil and gas reserves so necessary to the operation of all facets of our modern society. To that end, it explores the millions of acres of federally owned lands, primarily in the western United States, that represent the last remaining potential for significant field discovery. The stated public policy of the United States is to make these public lands available for mineral leasing in an effort to reduce our energy dependence on foreign sources.[1] Even so, the lower oil prices of recent years have encouraged Americans to increase oil consumption by 500,000 barrels daily, prompting the U.S. Department of Energy to warn that foreign oil dependency could well be at 50% within five years.[2] Continued reliance on oil underscores the need for accelerated exploration and development of domestic reserves.

On Federal lands, mineral leasing is authorized by the 1920 Mineral Lands Leasing Act.[3] If the lands have never been leased before, an oil company may acquire the rights to explore for oil and gas on the leased public lands. This right is contingent upon the company complying with the 1920 Act and subsequently passed statutes regarding public lands

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1. Park County Resource Council, Inc. v. United States Dep't of Agric., 817 F.2d 609, 620 (10th Cir. 1987).

2. Forsgren and Oliveria, *Oil and Gas in Wilderness Areas: The Need for Compromise*, W. WILDLANDS, Fall 1987, at 16.

3. 30 U.S.C.A. §§ 181-287 (West 1986 & Supp. 1988).

and the environment. Once the right is acquired, the company may typically use as much of the surface as necessary to fulfill the lease's stated purpose.

Many hundreds of thousands of dollars in exploration costs are incurred by a company prior to the decision to drill a well on federal lands.[4] This exploration may be at odds with the environmental concerns mandated by legislation adopted subsequent to the lease approval. Such legislation may demand a higher level of protection to surrounding surface resources than was contemplated or demanded at the time of lease issuance. As a result, government action taken subsequent to leasing may significantly restrict the exploration and development activity allowed on the leased lands. These restrictions may alter lease rights so as to give rise to the claim that a valuable property right has been adversely affected or even "taken" by subsequently adopted but retroactively applied federal law.

The Wild and Scenic Rivers Act of 1968[5] for example, can interfere with a mineral lessee's use and enjoyment of property rights. A river's subsequent designation as "wild and scenic" may permanently preclude bridges or other construction necessary for access to the wellsite. The right of ingress and egress is prohibited on the federal lease while the river designation review takes place, and permission to enter the drillsite may be withdrawn permanently if the river becomes designated as "wild and scenic." There is no "savings clause" for previously created, valid existing uses in this act. Only a constitutional attack can be mounted by the lessee in response to retroactive application of this law to the pre-existing property right.

Wilderness nonimpairment standards adopted pursuant to the Federal Land Policy and Management Act of 1976 (FLPMA)[6] may render previously issued federal oil and gas leases useless. In *Rocky Mountain Oil and Gas Association v. Watt*,[7] the Court of Appeals for the Tenth Circuit interpreted the nonimpairment standard to apply to pre-existing leases, despite a savings clause in the act exempting existing mining and grazing use. The only leases immunized from FLPMA's provisions were those with actual "on the ground" activity on the date of enactment (October 21, 1976).[8]

4. Rocky Mountain Oil and Gas Ass'n v. Watt, 696 F.2d 734, 741 (10th Cir. 1982).
5. 16 U.S.C. §§ 1271-1287 (1982 & Supp. IV 1986).
6. 43 U.S.C. §§ 1701-1784 (1982 & Supp. IV 1986).
7. 696 F.2d 734 (10th Cir. 1982).
8. *See also* Utah v. Andrus, 486 F. Supp. 995 (D. Utah 1979).

A more difficult and interesting question is raised by restrictions imposed due to agency noncompliance with an act's procedural requirements. The Forest Service and Bureau of Land Management's (BLM) noncompliance with the procedural provisions of the National Environmental Policy Act of 1969 (NEPA)[9] and the Endangered Species Act of 1973 (ESA)[10] has produced difficulties for mineral lessees. Post-leasing activities have been suspended while the courts wrestle with the BLM's alleged failure to comply with these acts by leasing national forest lands without preparation of full environmental impact statements and biological assessments. The BLM leased lands based upon Forest Service findings that leasing alone has no significant impact on the environment. However, the courts are not in agreement as to whether leasing alone has a significant effect on the environment. Two circuit courts have recently invalidated the agency action[11] and one has upheld it.[12] The mineral lessees remain uncertain as to the validity and status of their property while the courts decide if the act of leasing alone constitutes an irretrievable commitment of resources. If so, the agency must evaluate the environmental effects of its action at this point of commitment. Otherwise, the BLM has violated the procedural mandates of both NEPA and ESA.[13] In both *Sierra Club* and *Conner*, the courts validated those leases issued with no surface occupancy (NSO) stipulations, while invalidating those leases containing only restrictions on surface occupancy stipulations (non-NSO). The reason for this distinction is that future environmental danger to the lands by a lessee's drilling and mineral development activities could not be completely prohibited on non-NSO leases; the activities could merely be conditioned. The NSO leases, however, preclude surface disturbing activities entirely.[14]

Of the 709 Federal leases covering 1.3 million acres in Flathead and Gallatin National Forests at issue in *Conner v. Burford*, only 57 contained NSO stipulations over their entire surface.[15] The remedy adopted

9. 42 U.S.C.A. §§ 4321-4370 (West 1977 & Supp. 1988).

10. 16 U.S.C. §§ 1531-1543 (1982 & Supp. IV 1986).

11. Conner v. Burford, 848 F.2d 1441 (9th Cir. 1988), *superseding*, 836 F.2d 1521 (9th Cir. 1988) (the superseding opinion amended the original by adding footnote 40); Sierra Club v. Peterson, 717 F.2d 1409 (D.C. Cir. 1983).

12. Park County Resource Council, Inc. v. United States Dep't of Agric., 817 F.2d 609 (10th Cir. 1987).

13. *Sierra Club*, 717 F.2d at 1414.

14. *See generally* McCrum, *NEPA Litigation Affecting Federal Mineral Leasing and Development*, 2 NAT. RESOURCES & ENV'T 7 (Spring 1986).

15. *Conner*, 848 F.2d at 1447.

by the Court of Appeals for the Ninth Circuit was to add NSO stipulations to the remaining 652 leases so that NSO stipulations applied over the entire surface acreage. The court believed this remedy avoided the "unnecessarily harsh result of completely divesting the lessees of their property rights."[16] The NSO stipulations are to remain in effect until the Forest Service and the BLM comply with the procedural requirements of NEPA and ESA.

The BLM has suspended the leases until all appeals are exhausted or its compliance with the order is completed.[17] This action protects the lessee's interests by preserving the balance of the leases' primary terms while the controversy is resolved. The Ninth Circuit's injunction against any surface disturbing activity, however, instructs the agencies to ignore the commitments embodied in the non-NSO leases already sold.[18] These commitments are critical to the lessee's property right. Compliance with NEPA and ESA procedures may result in the BLM's inability to revalidate all of these leases as originally issued. If so, the most reasonable alternative will be for the BLM to permanently attach the NSO stipulations to the offending leases when the suspension is lifted and their primary terms again begin to toll. Such an alteration to the lessee's expectations by subsequent and permanent addition of NSO stipulations to their leases constitutes a severe hardship to the lessees.

This article considers whether the takings clause of the United States Constitution[19] has been violated when a NSO stipulation is permanently imposed on an established, pre-existing property right that did not contain an NSO stipulation. Of particular interest is whether this alteration of private property expectations can occur as a result of agency noncompliance with a statute's procedural requirements, when the private party has acted in good faith. These questions require an examination of the property right owned by the federal oil and gas lessee, the nature of the government's power to impact that right, and the possible protection afforded these property owners by the takings clause of the fifth amendment to the United States Constitution as most recently interpreted by the Supreme Court.

16. *Id.* at 1461 n.50.

17. Memorandum from Director, Bureau of Land Management, U.S. Department of Interior to State Director, Montana Bureau of Land Management (July 9, 1985) (discussing interim action in response to Conner v. Burford decision no. CV-82-42-BU).

18. Conner v. Burford, 848 F.2d 1441 (9th Cir. 1988), *superseding*, 836 F.2d 1521 (9th Cir. 1988).

19. U.S. CONST. amend. V.

II. NATURE OF THE PROPERTY INTEREST IN A FEDERAL OIL AND GAS LEASE

A leasehold interest in federal mineral rights is considered a less than fee interest estate in real property. Nonetheless, it is property whose loss must be compensated if it is deemed "taken" for fifth amendment purposes.[20] A leasehold interest is created by federal statutes such as the 1920 Mineral Lands Leasing Act as administered by the United States Department of the Interior through the BLM. A lease issued under the act does not convey title to the land and is not considered a vested right. Lessees must comply with the rules and regulations in effect on the date of the lease and those duly adopted thereafter.[21] The leases are, however, immune from denial or extinguishment by the exercise of secretarial discretion. They are property interests rather than mere expectancies. As property interests, they likely fall within valid existing rights language protecting pre-existing legal interests from operation of subsequently passed laws.[22] These non-vested protectable property rights may be regulated and their value diminished for proper public purposes.[23]

The lease grants to the holder the exclusive right to drill for, remove, and dispose of the oil and gas under the leased lands for a primary term of ten years and so long thereafter as oil and gas is produced in paying quantities. The lessee does not own the minerals in place, only the rights to explore for them. Once production is established, the lessee has the continuing right to produce the oil and gas until economic depletion. The lease term is perpetuated over this period if the lessee adheres to all other lease terms. Covenants to drill and reasonably develop are stated or implied in a federal lease as obligations of the lessee.[24]

The leases at issue in *Conner v. Burford* contain numerous environmental stipulations authored by both the Forest Service and the BLM, limiting use of their surface in order to protect endangered and other species, timber, and watershed. These "area specific" stipulations are, in addition to standard stipulations, seeking to minimize disturbance of the

20. Foster v. United States, 607 F.2d 943, 949 (Ct. Cl. 1979).

21. *See* Laitos and Westfall, *Government Interference with Private Interests in Public Resources*, 11 HARV. ENVTL. L. REV. 1, 14 (1987).

22. Solicitor's Opinion M-36910 (Supp.), 88 Interior Dec. 909, 912 (1981).

23. *Id.*

24. *See* Non-competitive public domain lease Form 3110-1, 11th ed. March 1977 Serial No. BLM M-43272, covering lands in Flathead County, Montana. *See generally* E. KUNTZ, CASES AND MATERIALS IN OIL AND GAS LAW (1986).

surface. The agencies require approval of a site specific plan by the Minerals Management Service (MMS) in consultation with the surface managing agency prior to any surface disturbing operation.[25] At issue in these procedural challenges to NEPA and ESA regulations, is whether such stipulations, taken as a whole, allow the agencies to later deny or only reasonably condition permits for site specific activity.

An NSO stipulation attached at lease issuance means that the lessee agrees to be subject to the agencies' absolute authority to prohibit surface use. The lessee of an NSO lease, sometimes called a contingent right lease, acquires no vested right to enter the surface to develop the leased minerals. Instead, he acquires an exclusive priority right to explore, should it ever be allowed, for the extent of the lease's primary term. Although some case law has held to the contrary,[26] there is little doubt that issuing leases with NSO stipulations is constitutional so long as the lessee is clearly informed of the limited property right he is acquiring.[27] An NSO stipulation applied retroactively by the BLM to a non-NSO lease, however, raises a serious takings question.

III. THE NATURE OF GOVERNMENT REGULATION OF PRIVATE PROPERTY INTERESTS

The government's authority to regulate private property interests is derived from the property clause and commerce clause of the United States Constitution.[28] This "police power" may be exercised to benefit the health, safety, and welfare of the people. This concept of public good or public purpose is broad enough to encompass the federal government's power to make laws that affect private rights in natural resources.[29] The government may redirect the benefits and burdens of economic life for public purposes despite upsetting otherwise settled private expectations.[30] In regulating leases of publicly owned minerals, Congress exercises both the proprietary powers of a landowner and the police powers

25. Federal oil and gas lease M-43272, *supra* note 24, attachment 3, Form 3109-5 (August 1973). *See generally* Burton, *Federal Leasing-Restrictions and Extensions*, 28 ROCKY MTN MIN. L. INST. 1133 (1982).

26. Rocky Mountain Oil and Gas Ass'n v. Andrus, 500 F. Supp. 1338 (D. Wyo. 1980), *rev'd on other grounds*, 696 F.2d 734 (10th Cir. 1982).

27. McCrum, *supra* note 14.

28. U.S. CONST. art. I, § 8, cls. 3, 17; U.S. CONST. art IV § 3 cl. 2.

29. L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 9-2, at 590 n.10 (2d ed. 1988).

30. Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211 (1986).

of a legislature.[31] Congress may prescribe rules necessary for the conservation of natural resources.

Laws in effect at the time of lease issuance are deemed incorporated into the lease terms. The lessee's rights are also subject to subsequently enacted law, unless statutory protection is afforded via valid existing rights exceptions. This clause in a statute excepts pre-existing property rights from application of the new law. This limitation on the government's power is often so narrowly construed, however, that the pre-existing property right is afforded little protection. Although the property right is subject to the subsequently enacted law, an overly restrictive regulation could constitute a taking of the property.[32] What is interesting about the *Conner* facts is that the NSO stipulations are not retroactively applied pursuant to subsequent law, but rather as the result of failure to adhere to procedural requirements of existing law. In either instance, the government's exercise of its power may give rise to a takings challenge.

IV. CONSTITUTIONAL PROTECTIONS AFFORDED PROPERTY RIGHTS VIA THE TAKINGS CLAUSE

The fifth amendment to the United States Constitution states, in part, "nor shall private property be taken for public use, without just compensation."[33] Three types of takings are implicitly recognized by the courts. First is the government's intentional exercise of the power of eminent domain through condemnation proceedings. Second is an unintentional taking or inverse condemnation through physical invasion where the government's intent is inferred. The third form of a taking of private property occurs when the government, in exercising its police power, so regulates property interests that they are deemed taken, thereby requiring that compensation be paid to the private property owner by the government.[34] The difficulty in determining a "regulatory taking" has been the subject of judicial controversy throughout most of the twentieth century.[35] In essence, it is a determination of whether the "public at large, rather than a single owner, must bear the consequences of an exercise of state power in the public interest."[36]

31. Union Oil Co. v. Morton, 512 F.2d 743, 747 (9th Cir. 1975).

32. *See generally* Comment, *FLPMA's Wilderness Study Areas: Valid Existing Rights and the Nonimpairment Standard*, 5 J. ENERGY L. & POL'Y 69 (1983) (effect of FLPMA'S nonimpairment standard as an interference with a mineral lessee's pre-existing rights).

33. U.S. CONST. amend. V.

34. *See* L. Tribe, *supra* note 29, § 9-4, at 595-97.

35. *Id.* at 595.

36. Agins v. City of Tiburon, 447 U.S. 255, 260 (1980).

In the past, the Supreme Court has engaged in an ad hoc factual inquiry on a case by case basis to determine if a regulation has constituted a "taking."[37] Recent decisions by the Supreme Court indicate that two different analytical approaches may be applied to a takings question. The first approach uses a three-part balancing test which evolved from *Penn Central Transportation Co. v. New York City*.[38] This test is elaborated upon in two 1987 cases, *Keystone Bituminous Coal Association v. DeBenedictis*[39] and *Hodel v. Irving*.[40] The three-part test represents a difficult threshold for the property owner to meet in a regulatory takings challenge. The second approach, which is a two-part disjunctive test, was originally set forth in *Agins v. City of Tiburon*.[41] This test was recently relied on by the Court in the important 1987 case of *Nollan v. California Coastal Commission*.[42] Under the *Agins/Nollan* test, a property owner has a better chance of being compensated because satisfaction of either part of the test constitutes a taking.

If an oil and gas lessee is faced with the subsequent addition of NSO stipulations to pre-existing lease rights, these 1987 cases may support a successful takings challenge. A discussion of the two analytical approaches and their application to a *Conner*-type mineral lessee confronted with new, onerous stipulations that were added because of agency failure to comply with procedural regulations will demonstrate the differences in the tests.

A. *The* Penn Central/Keystone *Analysis*

The test enumerated in *Penn Central* analyzes three factors of particular significance in determining if a taking has occurred: 1) the character of the government action, 2) the economic impact of the regulation, and 3) the extent to which the regulation interferes with investment-backed expectations.[43]

The rights claimed to have been taken in *Penn Central* were the air rights to commercially develop above a train station. The development

37. Keystone Bituminous Coal Ass'n v. DeBenedictis, 107 S. Ct. 1232, 1247 (1987); Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

38. 438 U.S. 104 (1978).

39. 107 S. Ct. 1232 (1987).

40. 107 S. Ct. 2076 (1987).

41. 447 U.S. 255 (1980).

42. Nollan v. California Coastal Comm'n, 107 S. Ct. 3141 (1987).

43. Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124 (1978). This three-part test was subsequently applied in Bowen v. Gilliard, 107 S. Ct. 3008, 3020 (1987); Hodel v. Irving 107 S. Ct. 2076, 2082 (1987); Keystone Bituminous Coal Ass'n v. DeBenedictis, 107 S. Ct. 1232, 1247 (1987); and Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979).

was precluded by "historic landmark" legislation.[44] The Court, viewing the property as a whole, decided that, although the air rights were economically impacted, they were only one strand in the bundle of the owner's property rights. The primary use of the property as a train station was unaffected by the regulation. Although the claimant's investment-backed expectations had been diminished, their primary value as a train station remained intact. The severity of the impact the law placed on the claimant's parcel did not warrant compensation. A mere showing that exploitation of a particular use of property has been denied is not a taking.[45] More importantly, the character of the government's action involved the preservation of historic landmarks, which is a proper public purpose. Laws that destroy or adversely affect recognized property interests or choose the destruction of one type of property for another more valued by the public are still valid when an appropriate public purpose is served.[46]

1. The Character of the Government Action

The character of the government action factor is elaborated upon in *Keystone*.[47] Here, a coal company claimed a taking by Pennsylvania's subsidence act that required half the minerals be left underground to prevent the surface from collapsing. The Court found the purpose of Pennsylvania's law was to arrest a significant threat to the public welfare and, therefore, the character of the action leaned heavily against finding a taking.[48] A property owner is held to an implied obligation that the use of his property will not be injurious to the community.[49] The character of the government's action is balanced against the economic and investment implications to the property owner. Regulations that safeguard public interests in health and the environment are most favorably weighed against the resulting impact to the property owner. In *Keystone*, although the company's expectation of profit had been diminished, the mine could still be operated profitably while an important public purpose was served.

44. *Penn Central*, 438 U.S. at 107.
45. *Id.* at 130.
46. *Id.* at 125.
47. *Keystone*, 107 S. Ct. at 1242.
48. *Id.*
49. *Id.* at 1245 (citing Mugler v. Kansas, 123 U.S. 623, 665 (1887)).

2. The Economic Impact of the Regulation

To examine the economic impact of a regulation in light of *Penn Central*, the Court considers the property as a "bundle of rights." Each potential property use is considered a right in the bundle. The economic impact of denying a potential use is then identified and balanced against the remaining elements of the test.

The use denied in *Keystone* (coal mining) was analogized to that in *Andrus v. Allard*.[50] In *Allard*, provisions of the Eagle Protection Act barred the sale of the feathers of endangered birds. The most valuable right in the bundle of property rights (sale of eagle feather Indian artifacts) was prohibited. But other valuable rights of ownership remained, such as possession and use for non-commercial purposes. The subsidence act in *Keystone* merely prevented mining of a portion of the coal on a given parcel. No use, however valuable to the property right, was completely denied.

Several cases have focused on the economic impact factor of the *Penn Central* three-part balancing test. In *Hodel v. Irving*, a regulation requiring small, fractionalized allotted Indian mineral interests to escheat to the tribe rather than descend by intestacy or devise, was held to be a taking. The ability to pass property to one's heirs was held an essential right in the bundle of property rights.[51] An ownership attribute deemed "essential" by the court carries a much greater economic impact to the property owner's rights than an attribute claimed "most valuable," as in *Allard*. Taken alone, the regulation might not have been a taking, but balanced against the character of the government regulation here, it did not pass constitutional muster. It was unnecessary for the government to completely abolish this essential right (descent and devise) to achieve its purpose of arresting fractionalization of the interests. Less restrictive alternatives were available to the government that were more closely tailored to its purpose without relieving the property owners of their rights.

The right to exclude others is also an essential right. A physical invasion of property outweighed the public purpose in *Kaiser Aetna v. United States*.[52] Here an owner's governmentally approved dredging of a channel from a private pond to a navigable bay resulted in the government claiming public access to the pond under its commerce clause powers over navigable waters. The legal right to exclude others was held a

50. 444 U.S. 51 (1979).
51. Hodel v. Irving, 107 S. Ct. 2076, 2083 (1987).
52. 444 U.S. 164, 179-80 (1979).

sufficiently important expectancy embodied in the concept of property ownership to require the government to pay for such an easement. In *Loretto v. Teleprompter Manhattan CATV Corp.*,[53] the court went even further in concluding that a permanent physical occupation by the government is a taking regardless of the public interests served. In all these instances, the nature of the economic impact on the property interest resulted in a taking of private property.

3. Interference with Investment-Backed Expectations

The uses reasonably relied upon and expected to continue comprise a property owner's investment-backed expectations. These expectations are the third factor weighed in the *Penn Central/Keystone* test.

In *Ruckelshaus v. Monsanto Co.*,[54] a takings challenge was raised against a regulation that required a company's trade secrets and proprietary data to be disclosed to the Environmental Protection Agency (EPA) when applying for new product registration. The EPA's explicit assurance of confidentiality formed the basis of a reasonable investment-backed expectation of the company. After the regulation was amended to exclude the Agency's assurance of confidentiality, however, the company could retain no such investment-backed expectation when it knowingly submitted the data in exchange for the economic advantage of registration.

Property owners must be completely thwarted in their expectations of profit. A mere diminution in value is insufficient to warrant a taking and is usually mitigated by other benefits. This reciprocity of benefit analysis is examined in *Bowen v. Gilliard*,[55] where a regulation requiring that outside child support payments be claimed as offsets to other public aid benefits was challenged. The court held the diminution in value of the child's interest was not substantial because it was offset by the additional benefits received. The extent of interference with investment-backed expectations was not severe enough to give rise to a taking of the property. Additionally, the child support was not considered a vested property right to which future expectations could accrue.

4. The *Penn Central/Keystone* Test Applied to *Conner*

The character of the government's action in *Conner* is to protect the

53. 458 U.S. 419 (1982).
54. 467 U.S. 986 (1984).
55. 107 S. Ct. 3008 (1987).

environmental value of the property while procedural requirements are fulfilled. Temporary application of the NSO stipulations to the leases does not implicate a taking since the leases are suspended pending resolution of appeal or satisfaction of the procedural requirements. If the leases are revalidated by the BLM with the NSO stipulation, however, the takings issue arises. The BLM would be enforcing the purposes of existing laws: NEPA and ESA. The important public policy of NEPA is agency avoidance of piecemeal decision making that "may fail to adequately consider the environmental ramifications of agency actions."[56] ESA requires that agency action not jeopardize the continued existence of any threatened or endangered species.[57] These are valid public purposes of sufficient importance to warrant retroactive application of the NSO stipulations to the leases. As the Court stated in *Penn Central*, "in instances in which a state tribunal reasonably concluded that the 'health, safety, morals, or general welfare' would be promoted by prohibiting particular contemplated uses of land, this Court has upheld land-use regulations that destroyed or adversely affected recognized real property interests."[58]

The next factor weighed is the economic impact of the regulation. The economic impact to the mineral lessee whose oil and gas lease now contains a NSO stipulation is severe. The primary purpose of the leases, which is to drill for and produce hydrocarbons, has been thwarted by denial of the surface access necessary to exploit the mineral estate. To implicate a taking in line with *Hodel* or *Kaiser Aetna*, the plaintiff must prove not only that the right is an essential right of the mineral lessee's property rights, but also that the use right has been completely destroyed. The ownership of the right to explore for the oil and gas is similar to a water appropriation right where an owner does not own the resource itself, but only the right to use (or explore for and produce) the resource.[59] Complete prohibition of such activity leaves little property value remaining.

The argument can be made, however, that significant value attaches

56. Park County Resource Council, Inc. v. United States Dep't of Agric., 817 F.2d 609, 620 (10th Cir. 1987).

57. Conner v. Burford, 848 F.2d 1441, 1451-52 (9th Cir. 1988), *superseding*, 836 F.2d 1521 (9th Cir. 1988).

58. Penn Central Transp. Co. v. New York City, 438 U.S. 104, 125 (1978).

59. *See generally* Laitos, *Constitutional Limits on Police Power Regulation Affecting the Exercise of Water Rights*, 16 COLO. LAW. 1626 (1987); Israel, *Emerging Federal and State Water Conflicts Affecting Western Coal Development*, 26 ROCKY MTN. MIN. L. INST. 157 (1980).

to the lessee's "right of first refusal" to explore should the NSO stipulations ever be lifted.[60] This is a valid residual right only if application of the NSO stipulations is temporary. In *Union Oil v. Morton*[61] the court reasoned that insofar as the government's denial of a permit to build a drilling platform necessary to further develop an offshore federal oil and gas lease was based upon factors that would not change in the foreseeable future, a taking had occurred. Likewise, in *Foster v. United States*,[62] where permanent denial of surface access on an air force base to the minerals below was deemed a taking, and in *Utah v. Andrus*,[63] where the court held that if access to property is indefinitely prohibited or if alternative access is unreasonably expensive, substantial takings questions are raised. All of the federal leases challenged under NEPA and ESA are within their primary terms and up to this time have not been accessible for exploration. If the environmental reasons for attaching NSO stipulations will not change within the leases terms, this "right of first refusal" is not a remaining valuable right in the lessee's property rights.

Other remaining strands of the lessee's property rights include the right to directionally drill from a non-NSO burdened lease to the underlying lands of the affected one and the right to pool an NSO lease into a larger producing spacing unit with non-burdened leases.[64] These may be valuable remaining expectancies. *Conner*, however, involved 1.3 million acres over 709 leases, thereby precluding the belief that for all practical purposes adjacent lands would be so unburdened in all but a very few instances. On the other hand, if NSO stipulations are only attached to a few of the revalidated leases in accordance with NEPA and ESA procedures, then this remains a viable and essential strand of the lessee's property rights.

The leases as originally issued explicitly granted the rights to restricted surface use for exploration of the oil and gas hydrocarbons below. This grant forms the basis of the lessee's reasonable investment-backed expectations. This expectancy has now been completely abolished by the NSO stipulations, since no explorative activities can occur. The lease's value as an inventory item or negotiating tool for the company is also severely depleted by the addition of NSO stipulations. The

60. *Conner*, 848 F.2d at 1461.
61. 512 F.2d 743 (9th Cir. 1975).
62. 607 F.2d 943 (Ct. Cl. 1979).
63. 486 F. Supp. 995 (D. Utah 1979).
64. *Conner*, 848 F.2d at 1447 n.16.

sui generis nature of an oil and gas lease distinguishes it from the *Keystone* facts where the company retains ownership of the minerals in place. In contrast, once the lease's primary term is reactivated, the lessee must expeditiously explore and produce or lose the property right altogether. The thousands of dollars invested in a lease will never be recouped in oil and gas revenues if surface access is denied by the implementation of the NSO stipulations on a majority of the leases.

5. Results of the Application

If only a few leases are revalidated with NSO stipulations, then a takings challenge cannot be sustained under the *Penn Central/Keystone* three-part balancing test. Although the most valuable use is denied, enough rights of the property right remain, such as the ability to directionally drill or pool the lease with non-NSO leases, that the economic impact factor of the test is not met. Likewise, the lessee's investment-backed expectations would not be completely diminished. Balanced against the laudable public purpose of environmental protection, a takings challenge is not sustained.

Revalidating a majority of the leases with NSO stipulations will also not sustain a takings challenge under the *Penn Central/Keystone* test. The reasonable, investment-backed expectations of the lessees are completely diminished here, since the NSO stipulations preclude exploration activity. Apparently, few rights in the property rights bundle remain. The right to use the surface to explore for the minerals below may be an "essential" use as well as the "most valuable" use of the property taken. The abolishment of these rights, however, is insufficient to warrant a taking when balanced against the important public purpose served. Only in instances of actual physical invasion of the property or an overbroad application of the police power purpose have the economic impact and investment-backed expectation factors outweighed the character of the government action in a takings challenge under the *Penn Central/Keystone* test. In *Conner*, the Government's purpose to protect the environment and endangered species from potential harm caused by mineral exploration is sufficiently important to outweigh the property rights lost by the lessees.

B. *The* Agins/Nollan *Analysis*

The takings analysis developed in *Agins v. City of Tiburon*[65] and *Nollan v. California Coastal Commission*[66] is distinguishable from those above in two very important ways. First, the takings test enumerated in these cases is a two-part, disjunctive test: a law applied to particular property effects a taking if it 1) does not substantially advance legitimate state interests, *or* 2) denies owners economically viable use of their land.[67] This particular framing of the takings analysis changes what a property owner must prove. A property owner affected by a regulation need not show that the overall balance of the *Penn Central/Keystone* test produces a taking. Under *Agins/Nollan* the owner need only show *either* that the regulation will not accomplish a valid goal, or that the regulation denies all "viable use." In addition, *Nollan* raises the standard by which the legitimate state interest is reviewed. The prohibition on the property use must now *substantially* advance the police power purpose served.[68]

Whether this "legitimate state interest" test of the *Agins/Nollan* analysis is analytically the same as the "character of the government action" factor of the *Penn Central/Keystone* test is unclear. Both focus, however, on the police power purpose behind the regulation enacted. Likewise, the alternative second test of *Agins/Nollan* that determines if a regulation "denies all economically viable use," employs both the "rights in the bundle" and "investment-backed expectation" criteria previously explored in *Penn Central/Keystone*.

A state court recently applied the *Agins/Nollan* takings analysis in *Orion Corp. v. State*.[69] This case demonstrates the difficulties inherent in the application of either the *Penn Central/Keystone* model or the *Agins/Nollan* model. The case involved an alleged taking of privately owned tidelands in Puget Sound by subsequent environmental legislation precluding development. The court first reviewed the regulatory purpose in line with *Keystone*, assuming that a law enacted for public safety purposes could never be subject to a takings challenge. Overcoming this barrier, the court applied the *Agins/Nollan* two part disjunctive test. This example highlights the complexity and overlap inherent in each of

65. 447 U.S. 255 (1980).
66. 107 S. Ct. 3141 (1987).
67. *Id.* at 3146; *Agins*, 447 U.S. at 260.
68. *Nollan*, 107 S. Ct. at 3150.
69. 109 Wash. 2d 621, 747 P.2d 1062 (1987), *cert. denied*, 108 S. Ct. 1996 (1988).

these quite different analyses that has not been resolved by the 1987 cases.

Both *Agins* and *Nollan* involve challenges to zoning and land use regulations. In *Agins*, an ordinance restricting construction on certain lands to one acre single family homes was held not to be a taking. In its analysis, the court assumed that the "economically viable use" was retained, because there were remaining uses which were not extinguished. Neither the best use nor a fundamental attribute of ownership was completely prohibited. The court was also not concerned with the severe economic diminution in value of the land, since some profitability expectations remained.

The court then applied the second part of the disjunctive test — the ends/means analysis. The court reviewed the government purpose (preventing problems of excessive growth) and the law enacted (minimum lot size) and found that the ordinance did substantially advance legitimate government goals. This analysis did not require the nexus between the two be exact, however. A sufficient link existed between the zoning regulation and the valid police power purpose of protecting residents from the ill effects of urbanization to uphold the law. A minimum rationality review of the governmental purpose was sufficient.

This deference to the character of the government action was no longer evident in *Nollan*. Here property owners challenged the state's action requiring an easement of their beach front as a condition to granting a building permit on the property. The court first reasoned that such a regulation did prohibit an essential use, the right to exclude others. Considered alone, demanding the beach front easement was a taking. Attaching it as a condition to the building permit, however, would be a permissible exercise of police power if it was reasonably related to the public burden created by the building construction.[70]

The condition was a valid exercise of police power only if the lack of such a condition would justify denying the permit. Both the legitimate state interest and the connection between that interest and the regulation enacted were more carefully scrutinized by the court than ever before in takings analysis. In *Nollan* that essential nexus between the two did not exist, and the easement was deemed a regulatory taking.

This heightened scrutiny between the proffered public benefit and the imposed condition signals a new respect for private property rights

70. *Nollan*, 107 S. Ct. at 3147.

by the court. A premonition of this higher standard regarding the government's police power purpose can be seen in *Hodel*, where the regulation was considered overbroad in extinguishing all devise and descent rights when less drastic means would suffice.[71] Apparently, the more restrictive the economic and investment expectations placed on the property owner are, the more closely tailored they must be to the government purpose. Under the *Agins/Nollan* analysis, the lack of this nexus produces an unjust and uncompensated taking of property.

1. The *Agins/Nollan* Tests Applied to *Conner*

Despite the heightened standard of judicial review, the legitimate state interest test of the *Agins/Nollan* analysis will not result in a taking of the mineral lessee's property. The governmental purpose served by the BLM retroactively applying the NSO stipulations to the leases is protection of the environment in compliance with procedural acts. The NSO stipulations will achieve the same goal of protecting the environment that prohibition of the leases would have achieved. Additionally, imposing the stipulations has a less disruptive impact on the property rights than outright refusal to revalidate the leases.

But *Agins* and *Nollan* provide property holders with an alternative ground to attack conditions—conditions may "take" property if they deny economically viable use. In *Conner v. Burford*, the NSO stipulations were not attached at lease issuance. Instead, in good faith the lessees expended numerous dollars acquiring non-NSO leases that were subsequently burdened with NSO stipulations. Under the "deny economically viable use" test of the *Agins/Nollan* analysis, the lessees may prevail. This test entails consideration of both the uses prohibited and the extent to which the investment-backed expectations of the property owner are diminished.

2. Results of the Application

Should all or most of the leases be revalidated by the BLM with NSO stipulations, a good case can be made that such action denied the mineral lessees all economically viable use of their property. Such a case would be based on the complete elimination of an essential right in their property rights bundle. The inability to conduct any activity on the surface prohibits their use of the property to explore for oil and gas entirely.

71. Hodel v. Irving, 107 S. Ct. 2076, 2083-84 (1987).

No offsetting remaining uses exist, such as the ability to directionally drill or pool the leases with non-NSO leases.

The lessee's investment-backed expectations must also be completely diminished. The lessee's expectations to drill and produce their non-NSO leases have been completely extinguished by the retroactive application of the NSO stipulations. There is also no opportunity to participate in production revenues by pooling or directionally drilling. The lessee's belief in and reliance upon the opportunity to produce the oil and gas under the public lands has been completely extinguished by the NSO stipulations. Because the nature of their property right is a terminable lease, the oil and gas lessee's expectancies are completely diminished.

These circumstances will satisfy part two of the *Agins/Nollan* disjunctive test whereby an unjust and uncompensated taking of property has occurred. If only a few of the leases are revalidated with NSO stipulations, however, enough economically viable use of the leases remain to preclude a successful takings challenge under either of the *Agins/Nollan* tests.

Once a court has determined that a taking has occurred, the government may amend the regulation, withdraw the regulation, or exercise its eminent domain powers.[72] No subsequent action, however, relieves the government of its duty to provide compensation for the period during which the taking is effective.[73] The BLM would probably not lift the NSO stipulations on the leases, since to do so would again implicate violations to NEPA and ESA. Instead, compensation for this regulatory taking would be granted the lessees based upon an economic formula. While this remedy mitigates the damage sustained, it does not help the mineral lessees achieve their wider purpose of exploration for oil and gas on the federal lands at issue.

V. CONCLUSION

The government may attach NSO stipulations to the exercise of the lessee's property rights for proper public purposes in three ways. First, the conditions may be attached at lease issuance with the knowledge and consent of the lessee. Second, conditions necessary to enforce subsequently enacted legislation may be retroactively applied to the existing

72. First English Evangelical Lutheran Church v. County of Los Angeles, 107 S.Ct. 2378, 2389 (1987).

73. *Id.*

property rights of the lessee. Third, conditions necessary to enforce existing laws but retroactively applied to valid property interests may be added to property rights correcting previous procedural errors.

Such a condition agreed to by the lessee at the time of lease issuance would not give rise to a taking issue. On the other hand, pre-existing property rights retroactively conditioned by subsequent law have been the subject of the majority of takings cases encompassing the current body of law. The same analysis as enunciated in these cases would apply to the *Conner v. Burford* facts where procedural error and subsequent substantive compliance attach conditions to pre-existing rights. The imposition of these NSO stipulations to the federal oil and gas lessee's pre-existing property rights may give rise to an unjust taking of property without compensation if the thresholds of either the *Penn Central/Keystone* balancing test or the *Agins/Nollan* disjunctive tests can be met.