PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

Montana Legislative Services Division

Legal Services Office

February 26, 2004

Senator Bob Keenan
President of the Senate
P.O. Box 697
Bigfork, Montana 59911

Dear Mr. President:

I am writing in response to your request for an analysis of the legal implications concerning the state scheme for funding the administration of trust lands with respect to the land grants for the Montana University System. The analysis of this issue involves consideration of The Enabling Act, the Montana Constitution, and the statutory provisions enacted to provide for the administration of state land.

The university land grants are contained in section 14 and section 17 of The Enabling Act. Section 14 of The Enabling Act grants land to the state, sets a minimum sale price of $10 per acre, provides that the proceeds of the land sale constitute a permanent fund to be safely invested by the state, and provides that the *income is to be used exclusively for university purposes*. The land may be leased in the same manner as provided in section 11 of The Enabling Act. The schools, colleges, and universities provided for in The Enabling Act are required to remain under the exclusive control of the state, and the proceeds arising from the sale or disposal of those lands may not be used for the support of any sectarian or denominational school, college, or university. Section 17 of The Enabling Act grants additional lands to the state for the establishment and maintenance of a school of mines, for state normal schools, and for agricultural colleges. These additional lands must be held, appropriated, and disposed of exclusively for the specified purposes in the manner that the Legislature may provide. Section 17 of The Enabling Act contains no language restricting the use of the income from this land.

The implementation of a land grant, the capitol land grant, was reviewed in State ex rel. Bickford v. Cook, 17 Mont. 529 (1896). The Montana Supreme Court held that the state had accepted the land grant and that the fund created by statute to receive the interest and income from the sale or lease of the land was a trust fund. The fund could not be used for any purpose except as provided in The Enabling Act. The Legislature had the power to control the fund and its disposition for the specific purposes for which the lands were granted.

These university land grant provisions of The Enabling Act were first construed by the Montana Supreme Court in 1898. After the Bickford decision, the Legislature enacted statutes authorizing the issuance of bonds for the construction and equipping of buildings for the state university secured by the pledge of the university land grant. The Montana Supreme Court held that the constitutional requirement that claims against the state had to be approved by the State Board of Examiners did not apply to the a warrant drawn on the bond fund. The bond fund was a

trust fund entirely different from a fund arising from taxation and was not a state fund over which the Board had control. State ex rel. Dildine v. Collins, 21 Mont. 448 (1898).

The Bickford and Dildine cases were followed in State ex rel. Koch v. Barret, 26 Mont. 62, 66 P. 504 (1901). In that case, the Montana Supreme Court reviewed the legislative implementation of The Enabling Act and the Montana Constitution. The Court determined that the Legislature had enacted statutes under which, in default of sale, all agricultural and grazing lands could be leased under the direction of the State Board of Land Commissioners for terms not exceeding 5 years. The revenue derived from the leases was required to be paid to the State Treasurer. The lands selected for the use of the agricultural college under the grant by Congress were subject to these statutes. The Court stated:

> . . . the manifest intention of congress was to create a permanent endowment, which was to be preserved inviolate; and to require that the revenues derived therefrom should be faithfully applied to the support of the institutions created, and not be diverted to other purposes. So long as this intention is carried out, we think it makes no difference what mode is adopted. The grant was made in view of conditions existing at the time, and others which might arise. Koch at 70.

The Court found that the leasing system was proper. It was not a condition precedent to require the sale of lands and investment of the proceeds prior to using income generated by the lands for their specified purposes. The distinctions placed on the various types of land grants came into play in a case involving the normal school land grant. In State ex rel. Haire v. Rice, 33 Mont. 365, 83 P. 874 (1906), the Court struck down Chapter 3, Laws of 1905, authorizing the State Board of Land Commissioners to issue and sell bonds, the proceeds of which were to be applied to the erection, furnishing, and equipping of an addition to the State Normal School at Dillon. The law authorized the Board to pledge as security, for the payment of the principal and interest on the bonds, funds realized from the sale and leasing of the lands granted by the United States under section 17 of The Enabling Act for normal school purposes and funds received from license fees for permits to cut timber on those lands. The Court found that the provision of The Enabling Act providing a land grant for normal schools pertained only to the manner of the management and disposition of the lands themselves. It did not control the funds derived from the sale or leasing of the lands. The funds derived from the sale and leasing of the lands passed to the state and could be disposed of as the state saw fit, subject only to the condition that the funds must be used exclusively for normal school purposes. The 1889 Montana Constitution, however, limited the usage of the normal school land grant proceeds. The Montana Supreme Court held that Chapter 3, Laws of 1905, violated Article XI, section 12, of the 1889 Montana Constitution. That section of the Constitution provided that the funds of the state university and all other state institutions of learning, accruing from any source, were to forever remain inviolate

and sacred to the purpose for which they were dedicated. The funds were to be invested as provided by law and were guaranteed by the state against loss or diversion. The interest earned on the invested funds, together with the rents from leased lands, was required to be devoted to the maintenance and perpetuation of the respective institutions. The Court concluded that the Constitution required the principal of land grant funds to be invested to draw interest. Therefore, that principal could not be used to pay the principal of or interest on the bonds. This holding was appealed to the United States Supreme Court. In Montana ex rel. Haire v. Rice, 27 S. Ct. 281, 204 U.S. 291, 51 L. Ed. 490 (1907), the United States Supreme Court affirmed the Montana Supreme Court, holding that the question of whether a state statute is repugnant to the state constitution is for the state court to determine and that the state court's decision is conclusive.

In State ex rel. Galen v. District Court, 42 Mont. 105, 112 P. 706 (1910), the Montana Supreme Court found that eminent domain could not be used to take state trust land. The Court held that the fund created from the sale of lands granted to the state by Congress for a particular purpose is a trust fund "established by law in pursuance of the Act of Congress". This finding necessitated strict construction of The Enabling Act. Galen was apparently overruled in State ex rel. Morgan v. State Board of Examiners, 131 Mont. 188, 309 P.2d 336 (1957), where the Court stated that The Enabling Act is to be liberally construed to accomplish the object sought to be attained.

In 1914, the people of Montana passed an initiative entitled "The Farm Loan Act", authorizing the State Board of Land Commissioners to invest the permanent common school fund and other permanent educational, charitable, and penal institution funds in certain school district bonds, state bonds, United States bonds, certain state warrants, capitol building bonds, irrigation district bonds, and first mortgages on good, improved farm lands in Montana. The Attorney General ruled in 1916 that the initiative was unconstitutional. The issue was presented to the Montana Supreme Court in the case of State ex rel. Evans v. Stewart, 53 Mont. 18, 161 P. 309 (1916). The Court disagreed with the Attorney General and upheld the validity of investing in farm mortgages. The Court determined that The Enabling Act did not attempt to regulate the manner in which the permanent funds derived from the grants are invested. Not all farm mortgages invested in were repaid. The Legislature enacted Chapter 127, Laws of 1935, recognizing the liability of the state to the public school fund pursuant to Article XI, section 3, of the 1889 Constitution, which provided that the public school fund "shall forever remain inviolate, guaranteed by the state against loss or diversion". The state was obligated to repay the school fund from the proceeds of such farm mortgage loans and lands and from other sources. Toole County Irrigation District v. State, 104 Mont. 420, 67 P.2d 989 (1937).

In a proceeding somewhat similar to Haire, the Legislature, in an extraordinary session in 1933, authorized the acceptance of a loan from the federal government under the National Recovery Act and the issuance of bonds for the construction of buildings for the Eastern Montana State

Normal School in Billings. The earnings of the institution and one-half of the interest and income from the land grant for normal schools under section 17 of The Enabling Act was pledged to repay the federal loan and to pay the principal and interest of the bonds. A challenge to Chapter 7, Special Laws of 1933, was brought on a variety of constitutional grounds. The Montana Supreme Court discussed the holding in Haire and concluded that the pledge of the land grant income to the payment of the bonds did not violate any provision of the Montana Constitution. The construction of the school buildings was within the "maintenance and perpetuation" of the Eastern Montana Normal School as provided in Article XI, section 12, of the 1889 Montana Constitution. The Court determined that "maintenance" meant "aid, support, and assistance". "Perpetuation" meant "the act of perpetuating or making perpetual; the act of preserving through an endless existence or an indefinite period of time". The term "maintenance" as applied to a school does not necessarily mean that it should be maintained perpetually. State ex rel. Blume v. State Board of Education, 97 Mont. 371, 34 P.2d 515 (1934).

The university land grant contained in section 14 of The Enabling Act was subjected to a similar analysis in State ex rel. Wilson v. State Board of Education, 102 Mont. 165, 56 P.2d 1079 (1936). In that case, in compliance with Chapter 133, Laws of 1935, the State Board of Education had applied to the federal Public Works Administration for a loan for the construction of a journalism building. The Board pledged the income and interest from the federal land grant to secure the loan and proposed to issue bonds secured by a pledge of the income and interest from the land grant. The language of section 14 of The Enabling Act requires the proceeds of the grant to be safely invested and the income from the investment to be used exclusively for university purposes. The Montana Supreme Court held that the State Board of Education had the power to pledge income and interest derived from the land grant fund of the university as security for repayment of a loan made to it for erection of the journalism building. The term "university purposes" in section 14 of The Enabling Act included the construction of necessary buildings. The Court also determined that "university purposes", as used in section 14 of The Enabling Act, is as broad as the words "maintenance and perpetuation", as used in Article XI, section 12, of the 1889 Montana Constitution.

It was recognized in the case of Newton v. Weiler, 87 Mont. 164, 286 P. 133 (1930), that the constitutional provisions relating to trust lands are limitations upon the power of disposal by the Legislature. The state is a trustee for the land grants and the funds derived from the sale or lease of the land. A trustee must strictly conform to the directions of the trust agreement. Toomey v. State Board of Land Commissioners, 106 Mont. 547, 81 P.2d 407 (1938). The directions of the trust agreement for land grants are those contained in The Enabling Act and the Montana Constitution.

In 1964, the Legislative Council requested an advisory opinion with respect to the Montana trust

and legacy fund, which encompassed the land grant funds. While the Court acknowledged that it did not issue advisory opinions, the provisions of Article XXI, section 17, of the 1889 Montana Constitution, establishing the Court as the supervisory board over the trust and legacy fund, required it to issue an opinion. The questions involved whether securities held by the trust and legacy fund could be sold or traded when the sale price was less than the face value or when the sale price was less than the price paid for the securities. The Court determined that the general authority to invest and administer the funds included the authority to administer the investments in a manner consistent with the realities of the securities market. There was implied authority to sell securities in the trust and legacy fund. The constitutional language requiring that the funds remain "inviolate" meant that the principal of the funds could not for any reason be permanently impaired, such as by the direct application of the funds to educational purposes or by a diversion to noneducational purposes. The constitutional directive that the invested funds be devoted to the maintenance and perpetuation of the beneficiaries is satisfied whether the interest is devoted directly or indirectly to the maintenance and perpetuation of the beneficiary. There is no constitutional violation when some of the interest is allocated to restoration of the temporary loss of principal if the overall effect is to improve the income posture of the funds. However, the Court noted that with respect to the land grant to agricultural colleges, section 16 of The Enabling Act and the underlying federal legislation prevented securities purchased with those funds from being sold for less than the purchase price or the face value of the securities. In re Montana Trust and Legacy Fund, 143 Mont. 218, 388 P.2d 366 (1964).

In 1967, the Legislature enacted Chapter 295, Laws of 1967, authorizing 2.5% of trust land revenue to be used to improve and develop the land in order to increase the value of the land or the revenue from the land. These provisions are currently codified as Title 77, chapter 1, part 6, MCA, and apply to all trust land, including university land. In 1993, a separate method of using timber sale revenue was enacted, and in 1997, the percentage of revenue deducted was increased to 3%. An Attorney General's opinion was requested to determine if the 1967 law violated The Enabling Act or the 1889 Montana Constitution. In 1967, Attorney General Anderson found that the law did not violate The Enabling Act or the constitutional provisions directing that school land revenue remain inviolate and sacred for school purposes, guaranteed against loss or diversion. 32 A.G. Op. 8 (1967). With respect to The Enabling Act, General Anderson cited Newton and Toomey as establishing the state as the trustee for the lands. General Anderson determined that in the execution of the trust imposed under the land grants, it was well settled that a state, acting in the role of trustee, has an inherent equitable right to reimbursement from the trust for all charges and expenses necessarily incurred in the execution of the trust where there is no provision to the contrary in the grant creating the trust. General Anderson cited U.S. v. Swope, 16 F.2d 215 (8th Cir. 1926), State ex rel. Greenbaum v. Rhodes, 4 Nev. 312 (1868), Betts v. Commissioners of the Land Office, 110 P. 766 (Okla. 1910), and Bourne v. Cole, 77 P.2d 617 (Wyo. 1938), for support of this proposition. With respect to the constitutional issue,

General Anderson noted that pursuant to Haire, the question of whether a statute is repugnant to the state constitution is a question for state courts and the state court's determination is conclusive. The General stated that he found no provision that indicated that the framers of the 1889 Montana Constitution intended to place restrictions upon the trustees' right to require payment for the expense of administration, conservation, improvement, and development of the trust lands out of the proceeds of the lands themselves. In the absence of a showing of that intent, the General concluded that the Legislature could allow a deduction of revenue from the school lands for land improvement. Section 2-15-501(7), MCA, provides that if an opinion issued by the Attorney General conflicts with an opinion issued by a city attorney, county attorney, or an attorney employed or retained by any state officer, board, commission, or department, the Attorney General's opinion is controlling unless overruled by a state District Court or the Supreme Court.

In December of 1990, I was asked to determine whether the Department of State Lands (now Department of Natural Resources and Conservation) could fund its management of trust lands from the interest from the permanent trust fund and the income from the trust lands. In my analysis, I noted that General Anderson did not discuss the requirement contained in Article XI, section 5, of the 1889 Montana Constitution, requiring that 95% of the interest income from the public school fund and 95% of the rents received from leasing and other income be apportioned to the school districts and that the remaining 5% of each source of revenue was required to be added to the public school fund. This provision of the 1889 Montana Constitution was carried forward in Article X, section 5, of the 1972 Montana Constitution. In 1990, I expressed bewilderment with the Attorney General's opinion, because I concluded that Article X, section 5, of the 1972 Montana Constitution appeared to contain exactly the type of specific trust restriction the Attorney General found to be absent. Also troubling was the Attorney General's reliance upon Betts. In Betts, the Oklahoma Supreme Court held that although there was nothing in the Oklahoma Enabling Act that prohibited the payment of expenses of administration from the sale or leasing of the granted land, Article 11, sections 2 and 3, of the Oklahoma Constitution when read in conjunction did prohibit most payments. While recognizing the general rule regarding trust restrictions, the Court determined that the Oklahoma Constitution did not allow the state to be reimbursed for expenses from "all the proceeds of the sale" of school lands. The state was also prohibited from using interest and income for paying the expenses of loaning or investing the permanent school fund. While Betts supports General Anderson's conclusion with regard to The Enabling Act, it reaches an opposite conclusion with regard to constitutional restrictions. When asked whether a constitutional provision governing income from trust land referred to "gross income" or "net income", the Alabama Supreme Court followed Betts. The Court held that "the income" arising from the sale of trust lands clearly excluded the thought that the income could be diminished by administrative costs. Opinion of the Justices, 47 So.2d 729 (Ala. 1950). These cases construed language less specific than that contained in Article X, section 5, of the

Montana Constitution, which specifies the treatment of 100% of "all interest", "all rent" received from leasing, and "all other income".

The other cases cited by General Anderson reach a different result. In Greenbaum, the Nevada Supreme Court found nothing in the intent of the constitutional convention to prohibit the Legislature from enacting a provision using a part of the trust estate to make the rest available. The Nevada Court determined that if the issue had been brought to the attention of the convention, the convention probably would have left the state where the act of Congress placed it, in the role of an ordinary trustee. The Court concluded that the issue was too doubtful and uncertain to allow it to find the act of the Legislature unconstitutional. The Nevada analysis is consistent with the analysis of General Anderson. However, a general rule of statutory and constitutional construction is that the intent of the framers is looked at only if the plain meaning of the language is not evident. Woirhaye v. District Court, 1998 MT 320, 292 Mont. 185, 972 P.2d 800 (1998). In Swope, New Mexico used 20% of the income from land grants to establish a state land office, to pay the salary and expenses of the employees of the office, and to pay for bonds used to fund a lands maintenance fund. The Eighth Circuit Court of Appeals found that where there is no provision in the granting of the trust estate relating to the expense of administering the trust, the necessary expenses of executing the trust may be paid out of the trust estate. The decision in Bourne is very fact-specific. In that case, Wyoming was concerned that it was not getting appropriate returns on land grant leases. The Legislature enacted a statute authorizing the hiring of an investigator to be paid out of recovered proceeds. The Wyoming Court found that the statute did not violate the Wyoming Enabling Act or the state constitution. Those documents addressed an existing fund. The statutory fund was not in existence and was only hoped for. Based upon that situation, the deduction of expenses was not determined to be illegal.

The Oklahoma Enabling Act contains language limiting the income from the land grants, interest on the investment of funds, and rentals of the land to be used "exclusively for the benefit of said educational institutions". Because that language is sufficiently similar to the requirement in section 14 of Montana's Enabling Act, that income from the university land grant is to be used exclusively for university purposes, I believe that the analysis in Betts is pertinent. As pointed out earlier, in Betts, the Oklahoma Enabling Act did not prohibit the state from using a part of the proceeds of land granted for university purposes to pay the expenses of the sale or leasing of those lands. The Oklahoma Court followed the holding of Greenbaum with respect to its Enabling Act language. The Oklahoma Court departed from Greenbaum only with regard to an analysis of the specific provisions of the Oklahoma Constitution. I have found nothing in the language of Montana's Enabling Act that is sufficiently unique so as to lead a court to prevent the recovery of the expenses of administering the land grants from the interest and income derived from the land. Therefore, the legal issue essentially boils down to whether the Montana

Constitution contains language that prevents the Legislature from enacting statutes that prevent the application of normal trust administration principles to land grant interest and income. That issue essentially devolves into whether the references to "interest and income" mean "gross interest and income" or "net interest and income".

With respect to the university system, the constitutional restriction on the use of interest and income would have to be found in the language of Article X, section 10, of the 1972 Montana Constitution. Article X, section 10, of the 1972 Montana Constitution provides:

> The funds of the Montana university system and of all other state institutions of learning, from whatever source accruing, shall forever remain inviolate and sacred to the purpose for which they were dedicated. The various funds shall be respectively invested under such regulations as may be provided by law, and shall be guaranteed by the state against loss or diversion. The interest from such invested funds, together with the rent from leased lands or properties, shall be devoted to the maintenance and perpetuation of the respective institutions.

A constitutional impediment to the current statutory scheme would have to be found in the language restricting the use of the interest on university land grant funds and rentals from leasing of that land to the maintenance and perpetuation of the respective institutions for which the grant was made. The Wilson decision determined that "university purposes", as used in section 14 of The Enabling Act, is as broad as the words "maintenance and perpetuation", as used in the Montana Constitution. Considering that holding in conjunction with the Betts and Greenbaum analysis of Enabling Act restrictions, I do not feel that this language is as "plain" as the language contained in Article X, section 5, of the 1972 Montana Constitution concerning public school fund revenue. I do not believe that the university system would have as strong a case as the K-12 public school system would have with regard to this issue. If a K-12 school case decision upheld the validity of the statutes, a university system challenge would almost assuredly fail.

My concern in 1990 was based upon the risk that the state was assuming because of the constitutional requirement contained in Article X, section 3, of the 1972 Montana Constitution that the public school fund is required to remain forever inviolate, guaranteed by the state against loss or diversion. Because of the requirement contained in Article X, section 5, of the Montana Constitution that 5% of all interest and income be redeposited in the permanent school fund, if the 1967 law and the 1990 proposal by the Department of State Lands were found to be unconstitutional, the state would be required to make the trust whole. This obligation was clearly established as a result of the failed investments in farm mortgages in 1935. The same concern applies to university land grants.

Sen. Keenan
February 26, 2004

In spite of my concerns with the 1967 analysis applied by the Attorney General to the provisions of Title 77, chapter 1, part 6, MCA, the Legislature has enacted additional statutes allowing the interest and income from land grants to be used by other state entities. Section 17-6-201(7), MCA, allows the Board of Investments to deduct the cost of administering and accounting for each investment fund from the income from each fund. As enacted in 1973, that provision excluded the trust and legacy fund, which encompassed the land grant trusts. That restriction was eliminated in 1991. In 1999, the trust land administration account provisions were enacted as sections 77-1-108 and 77-1-109, MCA. In 2003, the Legislature enacted the land banking statutes codified as sections 77-2-361 through 77-2-367, MCA. While the Montana Supreme Court has often disagreed with my legal analysis, the analysis is based upon my independent review of the pertinent law. Even though the 1967 Attorney General's opinion is binding until overturned by the Court, I felt compelled in 1990 and continue to feel compelled to advise the Legislature of what I consider to be a serious legal issue.

The post-1990 legislative decisions are particularly bewildering with regard to matters such as public school funding. The Legislature continues to appropriate general fund money far in excess of the amount of interest and income money retained by the Department of Natural Resources and Conservation for administrative purposes. If the interest and income money is determined to be constitutionally restricted, the state would be obligated to replenish the trust by the amount of the diversion. Because of the level of the general fund appropriation, it appears that risk is being incurred unnecessarily. A judicial resolution of this issue is desirable before the potential liability of the state becomes insurmountable. In the absence of a judicial resolution, the Legislature may want to engage in a risk-benefit analysis of these issues.

I hope that I have adequately responded to your request. If you have any additional questions, please feel free to contact me.

Sincerely,

Gregory J. Petesch
Director of Legal Services

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