ITEM 123-109-R0504

MEMO

TO: Board of Regents

FROM: LeRoy H. Schramm
Chief Legal Counsel

RE: Administrative Assessments on University System Land Grant Income

DATE: July 8-9, 2004

Introduction

The University System campuses are the exclusive beneficiary of five separate land grants given to Montana by the federal government at the time of statehood. These grants are protected by federal law and by the State Constitution which says that the income from the grants is "inviolate and sacred for the purpose for which they were dedicated" (Article 10, Sec. 10). I have previously provided the Board with a more extended discussion of the creation and legal status of the land grants (see attached memo dated July 11-12, 2002). Beginning in 1963, the state legislature began to divert some land grant income away from the beneficiary campuses and to the Department of State Lands (now the Trust Lands Management Division within the Department of Natural Resources and Conservation). Currently, five different assessments (4 by DNRC and 1 by the State Investment Board) on land grant income are made to fund functions and agencies outside the University System (for history of development of the assessments see memo of July 11-12, 2002).

The Dollar Amounts Involved

Currently, University System land grant income amounts to something in the neighborhood of $4.8 million annually (about $2.8 million from rents, royalties, timber sales, etc., and $2 million from interest on the trust funds). The annual administrative fees typically have been between $400,000 and $500,000 over the last several years. Because DNRC is going to begin assessing MUS timber sales revenue for the first time in FY 2004, the total administrative assessments are certain to rise significantly, probably to around $700,000 annually. **This will amount to approximately 25% of the non-interest MUS land grant income** (see Appendix for calculations)**!** Since inception of the fees, over $5,000,000 of University System land grant income has been taken with a present value between $11,000,000 and $12,000,000 (for a more

complete accounting and a summary of how these totals were derived see my memo to the Board dated March 16, 2003, attached hereto).

The Legal Status of the Administrative Assessments and Recent Developments

It has long been my opinion that the assessment of these administrative fees violates federal statute and the State Constitution. I have just learned that the DNRC voluntarily stopped making assessments against the Morrill Act Trust in FY 2003. I know of no statutory provision that exempts Morrill Act Trust income from any of the fees. Rather, this appears to me to be a tacit acknowledgment by DNRC that the Morrill Act Trust assessments are improper. Discontinuing the fee still does not address the over half a million dollars that has been assessed against Morrill Act Trust income in years past. The current value of these prior assessments is easily in excess of a million dollars. While all the assessments are legally questionable, because of specific federal statutory language that applies only to the Morrill Act Trust, it is in a class by itself. In my opinion a suit to recover Morrill Act assessments is almost an open and shut case.

The Assessment System Probably Can't be Fixed

Suspending the collection of fees against only Morrill Act Trust income also has the somewhat ironic effect of exposing and exacerbating another serious legal problem of the fee assessment system. The problem arises because while the DNRC has stopped making assessments against the Morrill Act income it has not lowered the total amount of its assessments. In other words, all the other trusts assessed by DNRC are paying a bit extra to make up for anything that would otherwise have come from the Morrill Act Trust. As I noted in a July 2002 memo to the Board (reproduced with the agenda materials for this meeting): "The federal case law is unmistakably clear that there can be no mingling of monies between funds and that one fund cannot be used to subsidize another. In *Lassen v. Arizona*, 385 U.S. 458 (1967), the Court examined the Arizona Enabling Act and struck down state legislation that used the assets of one trust to benefit other trusts. 'The Act thus specifically forbids the use of money or thing of value directly or indirectly derived from trust lands for any purposes other than those for which that parcel of land was granted. It requires the creation of separate trust accounts for each of the designated beneficiaries, prohibits the transfer of funds among the accounts, and directs with great precision their administration. Words more clearly designed to create definite and specific trusts and to make them in all respects separate and independent of each other could hardly have been chosen.' See also question 2, section 2 of 1996 *Washington Attorney General's Opinions* #11, disapproving of a process of paying joint administrative costs without a trust by trust justification that fees and expenses correspond for each trust. The Montana Supreme Court has cited *Lassen* and has made clear that the Montana Enabling Act, like that of Arizona, has established a system of separate and distinct land grant trusts. Indeed, even Montana statute imposes this requirement for at least one of the fees in question. 'Money in the resource development account . . . that is derived from the income from . . . university lands, agricultural college lands, scientific school lands, normal school lands . . . must be expended by the department solely for the purpose of

defraying the costs and expenses necessarily incurred in developing public lands of the same trust.' 77-1-606 MCA."

It is impractical and maybe impossible to develop a procedure where the costs of administering each individual trust are traced with the precision necessary so that each individual trust pays its share and no more. Therefore, even if the fees were otherwise legal (which I do not believe they are), the requirement that there be no cross-subsidization among the trusts presents a very big impediment to developing an acceptable method of assessing the fees.

The Statute of Limitations Does Not Limit Recovery

I do not think that any statute of limitations bars the Regents' right to seek recoupment for the current value of all fees taken from the land grant trusts (see July 11-12, 2002 memo noted above). In a recent filing in federal court the Montana Attorney General's Office asserted the school trusts' right to compensation from certain utilities that had constructed dams and reservoirs on trust property, beginning as early as 1913. The suit asked for compensation for "past and present use of State lands/school trust lands." I expect the Attorney General will argue that reimbursement to the trusts is not limited by any statute of limitations in much the same fashion as the Regents could argue should they go to court. *State ex. rel. Dolan v. PPL Montana e. al*., Cause CV-03-167, U.S. Dist. Ct. for the Dist. of Montana.

The Petesch Opinion

This Board in September 2002 had before it a formal Complaint, drafted at the Board's request, that could have been used to launch a lawsuit to recoup the lost land grant income. The Board deferred action and in March 2003, on the motion of Regent Mercer, decided to defer litigation and instead request the legislative leadership to solicit their own opinion on the issue from legislative counsel.

Thereafter, Commissioner Crofts forwarded the Board's request and Senator Keenan agreed to put the question of the legal propriety of the administrative fees to Greg Petesch, Director of Legal Services for the Legislative Service Division. On February, 26, 2004, Mr. Petesch issued his opinion (attached hereto). Although Mr. Petesch prudently declined to announce that the scheme of land grant fee assessments was absolutely legal or illegal, his informed discussion of the issues confirms that the Regents' arguments against the assessments have substantial merit. I believe his opinion vindicates the position that such assessments are on shaky legal ground.

Options

The Board has a range of options. These include (1) seeking legislation to end the system of administrative assessments, (2) going to Court to bar the assessments and to reimburse the trusts for lost revenue, (3) asking the attorney general for an opinion, or (4) trying to craft some acceptable compromise with the executive branch and the legislature that, for example, ends the

assessments and gives the trusts and the University System partial reimbursement in lieu of the right to sue for complete reimbursement.

The only option the Regents don't have is to do nothing indefinitely. Article III, Section 3 of the Montana Constitution requires public officers to "support, protect and defend" both the federal and state constitutions. The State Constitution says the revenues from the University land grants are "inviolate and sacred to the purpose for which they are dedicated." While there are always two sides to every legal question, the infirmities of the administrative assessment system are so manifest that the Regents must, one way or another, seek some resolution to these issues.

Appendix

PROJECTIONS

DNRC Assessments on MUS Land Grant Non-interest Income

Assume FY'04 non-interest trust income the same as FY'03 – About $2,800,000

Assume all FY'04 DNRC assessments, except timber sales assessment which was not levied, the same as FY'03 – About $348,000

Add anticipated timber sale assessment – About $350,000

Total anticipated DNRC assessment in FY'04 - $698,000

Total anticipated non-interest income ($2,800,000) compared to anticipated DNRC assessment ($698,000) means that the **assessments likely will take 24.9% of MUS non-interest land grant income.**

All Assessments on All MUS Land Grant Income

If one uses same assumptions and compares total anticipated '04 income (interest and non-interest) and all anticipated '04 assessments (including those of the State Investment Board) the numbers would be Approximately $4,800,000 (income) and $723,000 (assessments), meaning the **assessments likely will take 15% of MUS land grant total income.**

LHS/06-14-04

ATTACHMENT 1

Item 123-109-R0504

TO: Board of Regents

FROM: LeRoy H. Schramm
Chief Legal Counsel

DATE: July 11-12, 2002

RE: Administrative Assessments Against University Land Grant Income

The Questions

Five of the six University System campuses are beneficiaries of trusts created from federal land granted to Montana in 1889 as a condition of statehood. The trusts consist of both financial assets (generally called a permanent fund which produces interest and dividend income) and land (which produces income from payments for grazing leases, mineral leases, mineral, oil and gas royalties, and timber proceeds). Over the past 40 years the legislature has enacted a number of assessments whereby earnings of the University land grant trusts are used to fund either the activities of the Trust Lands Management Division or the State Board of Investment. I have been asked to render an opinion on the following questions.

1. Are the statutory assessments currently being applied against the University land grant trusts consistent with federal law, the state enabling act and the state Constitution?
2. If not, what options do the Regents have to correct the situation?

The Creation and Nature of the Land Grants

The Congressional Enabling Act of 1889, subsequently ratified by Montana along with its state constitution (see Ordinance No. 1, Sec. 7), gave Montana 72 sections (46,080 acres), the income of which was to "be used exclusively for university purposes" (Sec. 14), 90,000 acres "for the use and support of agricultural colleges" (Sec. 16), 100,000 acres "for the establishment and maintenance of a school of mines" (Sec. 17), 100,000 acres "for state normal schools" (Sec. 17), and 50,000 more acres for "agricultural colleges" (Sec. 17).[1] Via various enactments beginning

[1] States had received grants of federal land dedicated for educational purposes beginning with the General Land Ordinance of 1785 and the Northwest Ordinance of 1787 and extending all the way up to the admission of Alaska in 1959. For a concise history of the evolution of these grants see Fairfax, Souder and Goldenman, "The School Trust Lands: A Fresh Look at Conventional Wisdom," 22 Journal of Environmental Law 797, 803ff (Spring, 1992).

in 1893 the state legislature created a procedure by which the granted lands were identified,[2] and then created the institutions which were to be the beneficiaries of these land grants; the "university grant" to the institution at Missoula, the "agricultural college" grants to the institution at Bozeman; the "school of mines" grant to the institution at Butte, and the "normal schools" grant first to the institution in Dillon and then later, half to Dillon and the other half to the institution in Billings.[3]

Every section of state land selected was designated or assigned to one of the purposes listed in the Enabling Act. As the land was sold, leased or otherwise produced income that money was either distributed to the beneficiary campus or put into one of the five University System permanent funds.[4] The current acreages remaining from the original 1889 grants (including non-university land grants) are shown in Attachment A. The current dollar balances in the permanent funds created from the 1889 grants (including non-university land grants) are shown in Attachment B.

The Legal Status of Land Grant Income

In the almost 200 years that the federal government made educational land grants to states the conditions placed on the states' use of the land and its proceeds varied greatly. In some cases Congress granted the lands as a trust to be used for the specific purposes designated by the grant while in other instances the grant restrictions were viewed as less restrictive (i.e., honorary) than those imposed by a formal trust.[5] There is some question as to whether the language in the 1889 Enabling Act by itself creates a trust. But even if the Congressional language does not create a trust obligation, one can be created by the terms under which the state accepts the land.[6]

In Montana, both the 1889 and 1972 state Constitutions speak of these lands in terms of a trust. Art. X, Sec. 10 of the current Constitution speaks of the funds of the university and says they "shall forever remain inviolate and sacred to the purpose for which they were dedicated." Art. X, Sec. 11 speaks of "all lands of the state that have been or may be granted by congress" and says "they shall be held in trust for the people . . . for the respective purposes for which they

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[2] On how the actual tracts were identified and selected see Chapter IV, "Montana Locates Her Land Grants," in *History and Administration of Land Grants to Public Schools in Montana*, by Clarence Richard Anderson, Master's Thesis, Montana State University (Missoula), 1940. The first State Land Agent in charge of canvassing the state and selecting tracts was the well-known pioneer, prospector, vigilante, politician and author, Granville Stuart.

[3] See General Laws of 1893, pp. 171-181 for the initial designation of Bozeman, Butte, Dillon and Missoula. See Chapter 6, Laws of 1927 for the initial designation of the Billings institution as a state normal school.

[4] The five funds are the mining school fund, the university fund, the normal school fund, the agricultural school fund and the Morrill Act fund. The Morrill Act (passed by Congress in 1862) made funds for agricultural colleges available to states as they were admitted. The 90,000 acres granted in Sec. 16 of the Enabling Act is the Morrill Act land. It is kept in a separate account from the 50,000 acres granted for agricultural colleges in Sec. 17 of the Enabling Act because the federal restrictions on the two grants are different.

[5] For a discussion of the difference between grants given in trust and those given with less restrictive language see *United States Mine Workers of America v. State of Utah*, 6 F. Supp. 2d 1298 (D. Utah 1998) discussing Utah's closure of a miner's hospital funded by a federal land grant for a miner's hospital. See similar discussion in Wyoming Attorney General's Opinion 99-004 (August 25, 1999) on the fate of Wyoming's Miner's Hospital Land Grant Fund.

[6] "Washington [like Montana] entered the Union under the [1889] Omnibus Enabling Act which did not establish a trust. Washington's state constitution clearly did so." Fairfax, Souder and Goldenman, *supra* at 846.

have been or may be granted . . ."[7] In light of language such as this, it is easy to see why the Montana Supreme Court has long portrayed the land grants as trust obligations. "The grant of lands for school purposes by the federal government to this state constitutes a trust and the board of land commissioners, as the instrumentality created to administer that trust, is bound, upon principles that are elementary, to so administer it as to secure the largest measure of legitimate advantage to the beneficiary of it." *State ex rel. Gravely v. Stewart,* 48 Mont. 347, 349, 350, 137 P. 854 (1913) internal citations omitted.

The History of Administrative Deductions

The first of the five current statutory assessments relating to University trust income was enacted in **1963** (Sec. 219, Chapter 147, Laws of 1963, codified at 77-5-205(4) MCA). It is called a **Forest Improvement Fee** and it is assessed against any successful bidder for a timber contract on state trust land. The rate is not set by statute and varies from contract to contract, according to information provided verbally by personnel at the Trust Land Management Division.

In **1967** the legislature created a **Resource Development Account** (Chapter 295, Laws of 1967, codified at 77-1-604ff MCA). This was initially set at 2.5% of the income from the trust lands, and it has since risen to 3%.

In **1991** the legislature began to assess earnings from the permanent funds of the educational trusts to pay for the **administrative costs of the State Board of Investment** (Sec. 1, Chapter 291, Laws of 1991, codified at 17-6-201(7) MCA). Earnings of non-trust funds had previously been assessed in this fashion and continue to be so assessed. The amount is not set in statute and apparently varies depending on the needs of the Board of Investment.

In **1993** the legislature created the **Timber Sale Account** created from a fee assessed on trust timber revenues (Chapter 533, Laws of 1993, codified at 77-1-613 MCA). It is not clear to me whether this fee was ever assessed against University timber sales but the Trust Land Management Division has expressed an intent to do so if the Regents choose to take timber revenues as distributable revenue. The amount of the assessment varies depending on the amount the legislature appropriates for this Account each biennium.

In **1999** the legislature created the **Trust Land Administration Account** (Chapter 122, Laws of 1999, codified at 77-1-613 MCA). This account assesses fees on trust income in an annual amount equal to 1.125% of the value of the permanent fund.

Are These Assessments Legally Appropriate?

As noted earlier, one of the five University trusts is made up of lands and income derived from lands given to the state pursuant to the federal Morrill Act of 1862. That act contained the following language (at 7 USC 303).

[7] For comparable language see Article XVII, Sec. 1 of the 1889 Constitution.

> All the expenses of management, superintendence, and taxes from the date of selection of said lands, previous to their sales, and all expenses incurred in the management and disbursement of the moneys which may be received therefrom, shall be paid by the States to which they may belong, out of the treasury of said States, so that the entire proceeds of the sale of said lands shall be applied without any diminution whatever to the purposes hereinafter mentioned.

The Montana statutory assessments noted above are made against the Morrill Act trust in the same fashion as they are made against the other trusts. This seems without question to be inappropriate. See extended discussion disapproving of similar practice in 1996 *Washington Attorney General's Opinions*, #11.

With regard to the other trusts, federal law, including the Enabling Act, probably allows the deduction of administrative costs from trust income. *United States v. Swope,* 16 F.2d 215 (8. Cir. 1926), adopting for federal land grant trusts the general private trust rule that the trust administrator may pay costs of administration out of trust assets unless the document of trust indicates to the contrary. Therefore, the question is whether the Montana Constitution prohibits such assessments. The Montana Constitution says (Article X, Sec. 10):

> The funds of the Montana university system . . . from whatever source accruing, shall forever remain inviolate and sacred to the purpose for which they were dedicated . . . 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.

In 1977 the Idaho Supreme Court, relying on constitutional language that declared the corpus of Idaho's educational trusts "inviolate," held that the legislature could not skim off trust fund interest earnings to pay the administrative costs of the state board of investment. *Moon v. Investment Board*, 560 P.2d 871.[8] Similarly, the Oklahoma Supreme Court long ago held that even though federal law and the state enabling act might allow administrative expenses to be paid from federal educational trust income the state constitution disallowed the payment of the expenses of land administration or investment management expense because the state constitution said "all proceeds" from the trusts are dedicated to the use and benefit of the schools. *Betts v. Commissioners of the Land Office*, 110 P. 766 (1910). Similarly, the Alabama Supreme Court has determined that when used in relation to federal educational trust lands the term "income" without modifiers means gross income and not net income and no part can be diverted from the constitutional beneficiaries, the schools. *Opinion of the Justices*, 47 So. 729 (Ala. 1950).

To be sure, there are cases concluding otherwise, and even a Montana Attorney General's Opinion has concluded that the 1967 Resource Development Account funded by trust income does not offend the state constitution. 32 *Opinions of the Attorney General* #8 (Mont. 1967).

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[8] However, the Idaho Supreme Court later held that the costs of trust *land* administration could be paid from trust land income. *Moon v. Board of Land Commissioners*, 724 P.2d 125 (Idaho, 1986).

But this opinion seems vulnerable in that it clearly omitted a discussion of several relevant issues. First, it ignored the Morrill Act completely. Second, it failed to address the rather pointed, protective language of the state Constitution. See, e.g., Montana Legislative Council memo dated December, 1990, by Greg Petesch entitled *Land Grant Trust Administration*, questioning the 1967 Attorney General's opinion. Based on the strong protection that the Montana Supreme Court has traditionally given to the land grant trusts, and the very powerful constitutional language, it is reasonable to conclude that a court could find that the Montana constitution does not allow the diversion of land grant income for administrative expenses.

Even if Some Fees Were Allowable the Current Method of Assessment is Legally Inappropriate

The Trust Land Management Division assesses the fees based either on current income from each trust or based on the size of the permanent fund of the trust. Then the fees are expended for general operations purposes. The Trust Land Management Division doesn't keep a ready record of how much money is taken from the University trusts by the several assessments noted above. The Division, at OCHE request, has indicated that they will have a total compiled by the July 11 and 12 meeting so at that time we may have a better idea how much trust income is diverted from the trusts each year. Whether or not we will be able to easily tell how much came from each particular trust I do not yet know. But in any case, the amount of the fee assessed against any one trust does not likely correspond to the amount of administrative costs attributable to that same trust. This violates both federal and state law. One well established principle for federal land grant trusts is that the income of one trust cannot be used to benefit any beneficiary other than the specific beneficiary of that particular trust. The federal case law is unmistakably clear that there can be no mingling of monies between funds and that one fund cannot be used to subsidize another. "The Act thus specifically forbids the use of money or thing of value directly or indirectly derived from trust lands for any purposes other than those for which that parcel of land was granted. It requires the creation of separate trust accounts for each of the designated beneficiaries, prohibits the transfer of funds among the accounts, and directs with great precision their administration. Words more clearly designed to create definite and specific trusts and to make them in all respects separate and independent of each other could hardly have been chosen." *Lassen v. Arizona*, 385 U.S. 458, 467 (1967). See also question 2, section 2 of 1996 *Washington Attorney General's Opinions* #11, disapproving of a process of paying joint administrative costs without a trust by trust justification that fees and expenses correspond for each trust. Indeed, even Montana statute imposes this requirement for at least one of the fees in question. "Money in the resource development account . . . that is derived from the income from . . . university lands, agricultural college lands, scientific school lands, normal school lands . . . must be expended by the department solely for the purpose of defraying the costs and expenses necessarily incurred in developing public lands of the same trust." 77-1-606 MCA.

This prohibition on cross trust subsidization has another impact when considering Morrill Act lands. Even if fees were suspended for Morrill Act trust earnings the effect would merely be that the amount of the assessment on other trusts would increase. In other words, the other trusts would then be improperly forced to subsidize administrative costs of the Morrill trust.

Recoupment for the Trusts

The Montana Constitution (Article X, Sec. 10) says that land grant monies "shall be guaranteed by the state against loss or diversion." If the aforementioned fees have been improperly assessed against the funds the state is required to make the funds whole. See, *Toole County Irrigation Dist. v. State*, 104 Mont. 420 (1937). In *Toole County* the Supreme Court required the state to repay the various educational trusts for losses that the funds had incurred as a result of legislation passed almost 20 years earlier in 1919. Exactly what amount the funds would need to make up for the amounts diminished by the administrative fees over the years is impossible to say without a thorough accounting, but it assuredly would be a significant amount.

Options for the Regents

Because the amount of money involved is likely to be large and because it is likely that there will not be universal acceptance of our legal assertions (outside of possibly the very clear Morrill Act issues), I think it unlikely that the legislature would agree to terminate the assessments in the absence of a court order or an Attorney General's opinion. It is even more unlikely that the legislature would agree, in the absence of a directive from some court, to a method whereby the trusts could recoup past fees. The agencies involved in the fee assessments (the Trust Land Management Division and the Board of Investments) have no independent authority to ignore or reverse the statutes assessing the fees. Thus no point is served by making a request to these agencies. A longstanding principle of the Office of the Attorney General is that it is hesitant to offer a formal opinion on constitutional issues (the aforementioned 1967 opinion being an exception). One reason for this is that if a constitutional question manifests itself in a lawsuit the Attorney General has a presumed obligation to argue for the constitutionality of legislative enactments. Since the issues raised by the trust assessments are in large part constitutional the Attorney General likely would decline to give a formal opinion. And even if the Attorney General were to offer an opinion, and if it were to be favorable to the University trusts, it is not likely that the Attorney General has the independent authority to direct make-whole monies back to the trusts. Therefore, it appears that the most efficacious course would be to file an action in state district court. The exact nature of the action and who would have to be named as defendants is something on which more thought and research is needed.

Directive to Legal Counsel

At the current time all that is needed from the Regents is a yea or nay on the following:
University System legal counsel is directed to further explore the legal issues relating to administrative fee assessments and prepare documents necessary for an appropriate legal action seeking judicial resolution of the questions raised, and to bring the same back to the Board for consideration prior to the initiation of any action.

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COMMISSIONER OF HIGHER EDUCATION
OFFICE OF LEGAL COUNSEL

Item No. 123-109-R0504 ATTACHMENT 2
TO: Board of Regents
FROM: LeRoy H. Schramm, Chief Legal Counsel
RE: Lawsuit Regarding Administrative Charges Against University Land Grant Income
DATE: March 16, 2003

This memo relates to item "c" of part VII (System Issues) on the Board agenda for March 20 & 21, 2003. The item was mistakenly labeled "Timber Sales" initially, but it should instead be relabeled "Administrative Fees on Land Grant Revenues".

Background

At its July, 2002 meeting the Board the Regents considered for the first time the issue of whether statutory deductions from University Land Grant income used to fund the administrative operations of other state departments (primarily the State Lands Division of the Department of Natural Resources and Conservation) were consistent with the state constitutional requirement that "the funds of the Montana University System . . . from whatever source accruing, shall forever remain inviolate and sacred to the purpose for which they were dedicated." Art. X, Sec. 10. At that meeting I presented a memo to the Board (found at http://www.montana.edu/wwwbor/ITEM116-102-R0702.htm that included a history of the increasing number of administrative charges that have been levied against the University land grant income from 1963 to the present. The memo also reviewed case law from various states and concluded that, based on both state and federal law and Montana's very strong constitutional language, there is a good chance that some or all of the assessments would be found illegal.

The Board then instructed me to prepare a draft Complaint of the kind that would be filed if the Board were to take legal action to end the assessments and seek repayment of past assessments. At the September, 2002 meeting I presented the draft of such a Complaint to the Board (found at http://www.montana.edu/wwwbor/ITEM116-106-R0902.pdf). One question that arose at that meeting was the magnitude of the funds that had been lost by the University Land Grant Trust Funds over the many years the administrative assessments were made. At that time we were still awaiting an accounting of those fees from the Department of Natural Resources and Conservation. In part because of this uncertainty the Regents deferred authorizing the filing of any legal action. In October we received the desired information and an analysis follows.

The Value of the Fees Taken

Prior to 1963 all costs of administering the University land grants were paid for by state general fund revenue. The first administrative fee assessed against University land grant income was called the Forest Improvement Fee. In forty years (1963 through fiscal year 2002) that fee has amounted to $3,872, 815. The

Resource Development Fee (begun in 1967) has totaled $612,690. The Board of Investment management fee (begun in 1997) has totaled $19,228. The Trust Land Administrative Fee (begun in 1999) has totaled $527,023. The total of these four fees is $5,031,756. If one applies the statutory rate of interest to the fees paid each year the present value of the fees taken from the University land grant trusts is approximately $11,300,000.

It is useful to compare the magnitude of the fees against the annual income generated by University land grants. As of the end of fiscal year 2002 (June 30, 2002), the University land grants totaled 331, 255 acres (see annual DNRC report at http://www.dnrc.state.mt.us/trust/tlmdhome.htm). This generated approximately $4,463,000 in income of which $1,436,959 went back into the permanent trusts, $2,543,233 was distributed to the campuses and approximately $483,500 was paid in administrative fees (for the trust by trust totals of the monies going into the trusts and to each campus see http://www.dnrc.state.mt.us/trust/tlmdhome.htm). The administrative fees assessed in fiscal year 2002 were typical. Over the last three fiscal years (including 2002) the fees have amounted to $1,275,153, or an annual average of $425,051.

The amount of money in the University land grant permanent trust funds at the end of fiscal year 2002 was $21,448,076. That means that the that the $5,031,756 in fees taken since 1963 amounts to over 23% of the current trust funds balance. If one uses instead the present value of the 40 years worth of fees ($11,300,000) the percentage is over 52%. As noted in the July, 2002 memo cited above there is some reason to believe that this entire sum may be recoverable because no statute of limitations can protect a constitutional violation of this sort. That same memo notes that the argument against administrative fees is especially strong with regard to the trust fund derived from so-called federal Morrill Act land grant income (about 10% of our total). In 1999 the State of Washington agreed to pay Washington State University over $50,000,000 to reimburse the University for years of improper administrative assessments on that University's Morrill Act land grants (see WSU press release at http://www.wsu.edu/IR/wsulegis/olympia/99-15.htm). The same federal law that mandated that result in Washington also is applicable to the Montana. In addition, Montana has uniquely powerful constitutional language that applies to all the University System land grants.

Conclusion

The Regents are the trustees of the University System. They have an obligation to safeguard the assets of the University System and to assure that the assets due the System are received and used in a manner consistent with law. The practice of assessing administrative fees on University land grant income is arguably violative of the state constitution and state and federal law. It is my opinion that under those circumstances the Regents must take some action to seek a determination of the legal status of assessments against University land grant income. If the practice is determined to be legally infirm the Regents have further obligations to both seek an end to the practice and to seek restitution for the lost funds. A lawsuit is not the only way to solve this problem, but it is a sure way to get a definitive determination of the legal questions raised by the practice of administrative assessments.

ITEM 123-109-R0504 ATTACHMENT 3

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.
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