ITEM 123-109-R0504 ATTACHMENT 3

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 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

[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).

[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.

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 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

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[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.

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

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).

> 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.**