

**LETTER OPINION
2014-L-09**

June 3, 2014

The Honorable Scott Louser
State Representative
1718 Birch PI SW
Minot, ND 58701-7097

Dear Representative Louser:

Thank you for your letter asking whether the North Dakota Land Board is authorized to use interest and principal of the common schools trust fund to finance capital projects through the use of loans or grants. You also ask whether the common schools trust fund revenues from royalties should be categorized as “income” instead of “principal.”

ANALYSIS

I.

You ask about the Board of University and School Lands (Land Board) and whether it has either discretion or authority to access interest and principal of the Common Schools Trust Fund (Fund) to finance public school district capital projects through the use of grants and loans.

The Fund is a result of the Enabling Act (Act) passed on February 22, 1889, by Congress to facilitate the admission of Washington, Montana, North Dakota, and South Dakota into the Union.¹ Under the Act, the United States government granted the State of North Dakota more than three million acres to be used for the support of common schools.² Since the Act established the Fund as a permanent fund, the way the state may use the proceeds from the land is restricted.³

¹ 25 Stat. 676 (1889); State Highway Comm'n v. State, 297 N.W. 194, 195 (N.D. 1941).

² Sections 16 and 36 of every township in the state were granted for the support of common schools. See also N.D.A.G. 86-4.

³ 25 Stat. 676, §§ 10, 11 (1889).

North Dakota accepted the land grant “under the conditions and limitations” set out in the Act,⁴ and the Act directs that “proceeds” from these lands “constitute permanent funds” to support “the public schools.”⁵ The North Dakota Constitution provides that “[a]ll proceeds of the public lands that have been . . . granted by the United States for the support of the common schools . . . must be and remain a perpetual trust fund for the maintenance of the common schools of the state.”⁶

The Fund’s distribution method is set forth in N.D. Const. art. IX, § 2, which provides that “biennial distributions from the perpetual trust funds must be ten percent of the five-year average value of trust assets, excluding the value of the lands and mineral.”⁷ Once the Fund’s distribution is determined, the Legislature is able to implement the transfer and disbursement of the money to the schools.⁸ By statute, the distribution is transferred to the state treasury where it constitutes the state tuition fund.⁹ The money is then provided to the state’s school districts in the form of state aid payments.¹⁰ Depending on the amount of the distribution, the state aid payments are adjusted by the Legislature.¹¹

⁴ N.D. Const. art. XIII, § 3.

⁵ N.D. Enabling Act § 11. See also N.D.A.G. 2012-L-02. See also Kanaly v. State by and through Janklow, 368 N.W.2d 819, 823 (S.D. 1985) (the trust relationship created by Federal Enabling Legislation and state acceptance is an “irrevocable compact”).

⁶ N.D. Const. art. IX, § 1. See also N.D. Const. art. IX, § 2 (trust fund proceeds “must be faithfully used . . . for the benefit of the common schools . . . and no part of the fund must ever be diverted . . . or used for any purpose other than the maintenance of common schools.”); Moses v. Baker, 299 N.W. 315, 316 (N.D. 1941) (“The permanent school fund is a trust fund. It must be preserved intact. If there is any loss, the State is required to make it good.”); State ex rel. Bd. of Univ. & Sch. Lands v. McMillan, 96 N.W. 310, 314 (N.D. 1903) (Enabling Act’s land grant “was in trust,” with “the state as trustee to maintain the permanency of the funds”).

⁷ N.D. Const. art. IX, § 2. During the 2005 Legislative session, the Legislature passed a resolution to change the distribution method of the common schools trust fund from an “interest and income” approach to a “total return” approach. 2005 N.D. Sess. Laws ch. 624 (H.C.R. 3037).

⁸ N.D. State Const. Art. IX, § 3, 5, & 11; N.D.A.G. 88-23.

⁹ N.D.C.C. § 15.1-28-01.

¹⁰ These state aid payments have traditionally been used for the operational costs of the schools. Currently, the state provides an estimated 85% of operation costs to North Dakota school districts.

¹¹ See Dep’t of Trust Lands 60th Biennial Report (July 1, 2011 to June 30, 2013) (Total distributions to K-12 education for the 2011-2013 biennium were \$92,514,000, which equaled approximately \$462 per year for each K-12 grade student in the state).

You explain that school districts would like assistance from the Land Board in the financing of capital projects through grants or loans.

The Land Board is created by N.D. Const. art. IX, § 3 and “[s]ubject to the provisions of this article and any law that may be passed by the legislative assembly, the board has control of the appraisal, sale, rental, and disposal of all school and university lands, and the proceeds from the sale of such lands shall be invested as provided by law.”¹² The Land Board also has full control of the investment of the permanent funds derived from the sale of any of the lands.¹³ The Land Board has a fiduciary duty to manage and safeguard the trust property because the Board “acts . . . on behalf of the state” and as the state’s “trustee.”¹⁴ Any investments must comply with N.D.C.C. § 15-03-04, the “prudent investor rule,” which requires the trustee to exercise reasonable care, skill, and caution, in making investments with a view both to safety of principal and securing a reasonable return.¹⁵

The Land Board could not gift or grant funds because grants deplete the fund with no possibility of a return. This would be a violation, not only of the terms of the permanent fund as set forth in the Act and the state constitution, but also of N.D. Const. art. X, § 18, commonly referred to as the “anti-gift” clause.¹⁶

Past opinions indicate the Land Board could make loans without violating N.D. Const. art. X, § 18 because loans do generate returns.¹⁷ However, the state constitution states that “no part of the fund must ever be diverted, even temporarily, from this purpose”¹⁸ or used for any other purpose which prevents the Land Board from entering into an unfair exchange. When considering any loan, the Land Board must consider its constitutional and fiduciary duties as trustee of the common schools trust fund. This means the Land

¹² N.D. Const. art. IX, § 3. See also N.D.A.G. 94-L-73 (Mar. 30, 1994).

¹³ N.D.C.C. § 15-01-02(2).

¹⁴ N.D.A.G. 2012-L-02; Fuller v. Bd. of Univ. & Sch. Lands, 129 N.W. 1029, 1031 (N.D. 1911).

¹⁵ N.D.A.G. 1992-L-13.

¹⁶ N.D. Const. art. X, § 18 (“neither the state nor any political subdivision thereof shall otherwise loan or give its credit or make donations to or in aid of any individual, association or corporation except for reasonable support of the poor”).

¹⁷ N.D.A.G. 67-220 (State Employee’s Retirement Fund could make investments without violating N.D. Const. art. X, § 18 because through the Retirement Fund, the state was “engaged in the investing business for its employees which is a lawful business or enterprise.”). N.D.A.G. 92-13 (investment activities by the Land Board concerning the coal severance tax trust fund under N.D. Const. art. X, § 21, and later, the Myron G. Nelson Fund constituted a lawful enterprise engaged in for a public purpose).

¹⁸ N.D. Const. art. IX, § 2.

Board could not agree to offer loans at an interest rate lower than the current market rate or without regard to the quality of security pledged.

To a degree the Land Board is subject to legislative authority. But the “source of authority of the board is the constitution itself and not the legislature.”¹⁹ Previous opinions have explained that “constitutional language²⁰ and judicial comment²¹ do not give the legislature carte blanche to do what it wishes with the school trust.”²² Were it otherwise, “a potentially self-defeating incompatibility [would exist] between the stated purpose and objective of the trust on the one hand, and the alleged unbridled authority granted the State Legislature to defeat the strategy by means of creative rules and regulations on the other hand.”²³ Any legislative control over the Fund must be “within the limits of the constitution” and compatible with the Land Board's fiduciary duties.²⁴

It is my opinion that the Land Board has investment authority but must comply with the prudent investor rule and the constitutional limits of the Fund. Whether a specific investment in bonds related to a school district's capital project complies with these limits is a question of fact which must be addressed in the first instance by the Land Board itself, taking into consideration its investment strategies and its portfolio of investments.²⁵

¹⁹ State ex rel. Rausch v. Amerada Petroleum Corp., 49 N.W.2d 14, 23 (N.D. 1951) (when the legislature acts with respect to the powers of the board, it acts in a restrictive capacity and not as a conferrer of authority).

²⁰ N.D. Const. art. IX, §§ 3 and 5.

²¹ State ex rel. Bd of Univ. & Sch. Lands v. Hanson, 256 N.W. 201, 204 (N.D.1934) (“it has been the legislative policy to control the ... [land] board.”).

²² N.D.A.G. 88-23.

²³ Okla. Ed. Ass'n, Inc. v. Nigh, 642 P.2d 230, 237 (Okla.1982). See also Fox v. Kniep, 260 N.W.2d 371, 374 (S.D.1977), cert. denied, 436 U.S. 918 (1978); State ex rel. Interstate Stream Comm'n v. Reynolds, 378 P.2d 622, 627 (N.M.1963).

²⁴ State, 256 N.W. at 204. (“The provision in [art. IX, § 3] of the Constitution, giving to the board the power to ‘direct the investment of the funds’ subject to ‘any law that may be passed by the legislative assembly,’ contemplates legislative control of the school funds, within the limits of the Constitution.”). See also State Hwy. Comm'n v. State, 297 N.W. 194, 195 (N.D.1941); State v. Towner Cnty., 283 N.W. 63, 66 (N.D.1938); State ex rel. Sathre v. Bd. of Univ. and Sch. Lands, 262 N.W. 60, 65-66 (N.D.1935) (any diversion of the trust's principal, interest, or income to purposes other than those for which the land grants were made is unconstitutional); State Bd. of Educ. Lands and Funds v. Jarchow, 362 N.W.2d 19, 26 (Neb.1985) (the legislature is without power to bestow a special benefit upon any public or private entity at the expense of the beneficiary, the public school system of the state); N.D.A.G. 88-23.

²⁵ See sources cited supra n. 24.

It is my opinion that the Land Board is not authorized to provide grants from the Fund without legislative authority subject to the constraints of the state constitution. Loans or a loan program may be reasonable, but only if such loans are consistent with the limits of the constitution and the Board's fiduciary duty to secure reasonable returns. Whether a particular loan or program complies with the prudent investor rule and the constitutional limits of the Fund is a question of fact that I am unable to answer without knowing the particulars of the proposed loan or program.

II.

You next ask whether the common schools trust fund revenues from royalties should be categorized as "income" instead of "principal?"

I assume you are referring to mineral royalties. Generally, when a trust asset is sold, the proceeds from the sale of the asset remains characterized as "principal." Royalties are compensation for the one time depletion of a trust asset and would continue to be considered "principal."

In this instance, the characterization of royalties is irrelevant because N.D. Const. art. IX, § 2 does not make a distinction between "income" and "principal." Instead, the state constitution only requires that "[r]evenues earned by a perpetual trust fund must be deposited in the fund."²⁶ "Revenue" is "a broad and general term, including all public moneys which the state collects and receives, from whatever source and in whatever manner."²⁷ Therefore, regardless of how royalties are categorized, the trust receives the revenues.²⁸ There is no authority in either the Act or the state constitution to treat royalty revenue from trust lands differently than other kinds of revenue.

Once revenue from sources such as royalties, proceeds of asset sales, income earned by the land, or interest earned by the Fund is deposited into the permanent fund it becomes part of the Fund and is subject to the restrictions on the Fund's use, as I have discussed above.²⁹ I note that because the distribution method for the Fund calculates ten percent of

²⁶ N.D. Const. art. IX, § 1. See also Enabling Act § 11 (The Enabling Act directs that "proceeds" from trust lands "constitute permanent funds" to support "the public schools"); N.D.A.G. 2012-L-02.

²⁷ Black's Law Dictionary, 1318 (6th ed. 1990).

²⁸ In a trust, the money received from the sale of any asset remains a principal asset, although in a different form. Here, the royalty interests are trust assets so the money received from the royalties would be considered principal rather than income.

²⁹ Enabling Act § 2; N.D. Const. art. IX, §§ 1 & 2. See also N.D.A.G. 88-23 (lands later acquired by the school and institutional trusts become part of the fund).

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the five year average value of trust assets, any increase in revenue from royalties will increase the amount distributed to the trust beneficiaries.³⁰

It is my opinion that royalties from mineral leases on land in the common schools trust fund constitute revenue from the trust lands and as such, constitute permanent funds.

Sincerely,

Wayne Stenehjem
Attorney General

mkk/vkk

This opinion is issued pursuant to N.D.C.C. § 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts.³¹

³⁰ N.D. Const. art. XI, § 2.

³¹ See State ex rel. Johnson v. Baker, 21 N.W.2d 355 (N.D. 1946).