

N.D.A.G. Letter to Kingstad (Aug. 19, 1992)

August 19, 1992

Mr. Tim Kingstad
State Land Commissioner
State Land Department
918 E Divide Avenue, Suite 410
Drawer 5523
Bismarck, ND 58502-5523

Dear Mr. Kingstad:

Thank you for your June 10 and July 8, 1992, letters in which you ask about the propriety of commingling various state funds for investment purposes. In particular, you ask whether the funds managed by the Board of University and School Lands (Land Board) can be commingled amongst themselves, as well as with the State Bonding Fund, State Fire and Tornado Fund, and Worker's Compensation Fund.

Most of the funds managed by the Land Board are held as revenues from lands granted to North Dakota at statehood from the federal government. N.D. Enabling Act §§ 10-19, 25 Stat. 676 (1889); N.D. Const. art IX. These lands were held in trust and the proceeds from the sale of these lands constitute a permanent trust fund. State v. McMillan, 96 N.W. 310, Syllabus 1 (N.D. 1903). Two other trust funds managed by the Land Board are the Coal Trust Fund established by N.D. Const. art. IX, § 21, and the Lands and Minerals Trust Fund established by N.D.C.C. §§ 15-08.1-08 and 61-33-07.

The State Bonding Fund is established by N.D.C.C. ch. 26.1-21, the State Fire and Tornado Fund by chapter 26.1-22, and the Worker's Compensation Fund by chapter 65-04. Each of these chapters direct that investment of the funds is the responsibility of the State Investment Board and is to be in accordance with N.D.C.C. ch. 21-10. N.D.C.C. §§ 26.1-21-05, 26.1-22-04, 65-04-03.1.

I will first address whether the Land Board's funds can be commingled amongst themselves and then discuss whether they can be commingled with the Worker's Compensation, Bonding, and Fire and Tornado Funds.

The Land Board is charged "with the duty of directing the investment of funds derived from the sale of lands granted by the United States to . . . North Dakota for support of the common schools and from other sources. . . . It is vested with discretion in performance of its duties." Moses v. Baker, 299 N.W. 315, 316 (N.D. 1941). See also Fuller v. Board of University and School Lands, 129 N.W. 1029, 1031 (N.D. 1911) (the Land Board is "vested with discretion in the performance of its duties generally"). The Land Board also has

discretion in managing the Coal Trust Fund and the Lands and Minerals Trust Fund. N.D. Const. art IX, § 21 (the Land Board "shall have full authority to invest said [coal] trust funds as provided by law"); N.D.C.C. § 15-08.1-06 (the Land Board "shall manage, operate, and supervise all properties [in the lands and minerals trust fund]").

Furthermore, the Land Board's investment practices are governed by the prudent investor rule as set out in N.D.C.C. § 15-03-04:

15-03-04. Legal investments. Subject to the provisions of section 15-03-05, the board of university and school lands shall apply the prudent investor rule in investing the permanent funds under its control. The "prudent investor rule" means that in making investments the board shall exercise the same judgment and care, under the circumstances then prevailing and limitations of North Dakota and federal law, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

Principles governing the administration of trusts apply to the state acting as a trustee. See Oklahoma Education Association, Inc. v. Nigh, 642 P.2d 230, 236 (Okla. 1982); State v. Board of Educational Lands and Funds, 47 N.W.2d 520, 523 (Neb. 1951).

Legal encyclopedias and treatises confirm the propriety of pooling trust funds for the purposes of investment. "The practice of combining trust funds [for investment] has long been recognized as proper for a trustee." 76 Am. Jur. 2d Trusts § 515, p. 501 (1992). See also 90 C.J.S. Trusts § 329, p. 551 (1955). "The rule against the mingling of funds of separate trusts is not violated merely because the trustee in making investments combines trust funds." A. Scott and W. Fratcher, IIA The Law of Trusts § 179.2, p. 505 (4th ed. 1987). Another treatise states that courts tend "to permit the mingling of two or more trust funds in an investment, provided the trustee keeps accurate books with regards to the shares of each trust. . . ." George G. Bogert and George T. Bogert, The Law of Trusts and Trustees § 596, p. 464 (2d ed. rev. 1980).

These legal authorities are based upon such cases as Finley v. Exchange Trust Company, 80 P.2d 296 (Okla. 1938), and In Re Union Trust Company, 114 N.E. 1057 (N.Y. Ct. App. 1916). In Finley, the court's syllabus states:

A trustee having in its hands funds belonging to several trust estates may combine same for purpose of investment, provided the investments are in other respects proper, and proper records are kept showing the amount contributed by each trust estate.

Finley, 80 P.2d at 298. The New York Court of Appeals has stated that "the combination of trust funds for investment is generally recognized as proper . . ." In Re Union Trust, 114 N.E. at 1058.

It may also be noted that the North Dakota legislature has authorized commingling of trusts for investment purposes. N.D.C.C. § 6-05-15.2(1) states: "[a]ny trust company . . . may commingle funds for investment." N.D.C.C. § 6-05-15(1) states any bank or trust company may:

Establish and maintain common trust funds for the collective investment of funds held in any fiduciary capacity by it or by another bank or trust company which is owned or controlled by a corporation which owns or controls such bank or trust company.

While these statutes do not govern the Land Board's management of school trust funds, they do express the idea that there is nothing inherently wrong with commingling trust funds for investment.

There are two constitutional provisions that bear upon this issue. Neither, however, prohibits commingling for investment.

N.D. Const. art. IX, § 1 states in part:

All property . . . received by the state from whatever source, for any specific educational or charitable institution, unless otherwise designated by the donor, shall be and remain a perpetual trust fund for the creation and maintenance of such institution, and may be commingled only with similar funds for the same institution.

This provision does not prohibit commingling for investment. It ensures that the identity of a fund's assets are always maintained and that the identity is not lost by mixing the assets with those of another fund. Commingling funds for investment does not mean the loss of a fund's identity. Provided careful "earmarking" and "tracking" mechanisms are maintained when commingling, this constitutional provision will not be violated. Courts have ruled that the loss of a separate identity is the crux of commingling. See, e.g., Surgi v. First Nat'l Bank Trust Co., 125 F.2d 425, 429 (5th Cir. 1942); Pfau v. State, 47 N.E. 927, 928 (Ind. 1897).

N.D. Const. art. IX, § 7 refers to funds received from the sale of lands received by the state for the benefit of specific educational or charitable institutions and states: "a distinct and separate account shall be kept by the proper officers of each of said funds" This requires adequate recordkeeping to ensure that the assets of a fund are never lost. Again, commingling for investment does not necessarily mean that separate accounts cannot be kept for each fund or that the funds will lose their distinct identities.

Based on the above analysis, it is my opinion that it is lawful for the Land Board to commingle for investment purposes the trust funds it manages. However, this may be done only if the funds commingled are "earmarked," that is, only if the separate identity of each fund is maintained. Careful records must be kept of the amount of money from each

fund commingled and the amount each fund earns from the investment. Furthermore, the commingling must be managed in a way that ensures that any losses and charges are properly allocated to each fund. This is consistent with N.D.C.C. § 21-10-06, which states that "[s]eparate accounting must be maintained for each of the . . . funds."

For the same reasons that the Land Board may commingle its funds for investment, it may also commingle its funds with funds managed by the State Investment Board. As mentioned, the Bonding, Fire and Tornado, and Worker's Compensation Funds are to be invested by the State Investment Board in accordance with N.D.C.C. ch. 21-10. N.D.C.C. §§ 26.1-21-05, 26.1-22-04, 65-04-03.1. N.D.C.C. ch. 21-10 states that the State Investment Board "is charged with the investment" of these funds and N.D.C.C. § 21-10-07 states that the State Investment Board is to apply the prudent investor rule and provides a definition of that rule which is virtually identical to the definition set out in N.D.C.C. § 15-03-04. N.D.C.C. §§ 21-10-02, 21-10-06. Like the Land Board, the State Investment Board has broad discretion. Therefore, the general principles discussed above allowing commingling for investment also apply to the State Investment Board.

The Land Board and the State Investment Board are, however, each responsible for developing and implementing their own investment policies, and the ability to commingle their funds in no way diminishes their separate responsibilities in that regard.

If you have further questions of this matter, please contact me.

Sincerely,

Nicholas J. Spaeth

cmc/kb