LETTER OPINION
74-20

January 10, 1974 (OPINION)

Mr. R. E. Lommen
State Land Commissioner
State Capitol
Bismarck, ND 58501

Dear Mr. Lommen:

This is in reply to your letter dated November 15, 1973, in which you inquire as to whether or not the securities held for investments can be sold at a loss and reinvested in order to obtain a higher yield on the investments for the common schools and other institutions. In your letter you state:

> "During the 1969 Legislature, Senate Concurrent Resolution No. 62 was introduced for the purpose of amending sections 153 and 156 and repealing Sections 159 and 162. This resolution passed both the House and Senate and appears as Art. 89, S.L. 1969, ch. 594. The amendment was submitted to the people for approval and was approved on September 1, 1970, S.L. 1971, ch. 618. This department has taken the position that that particular amendment does not permit the sale of securities at a loss.

"We have examined the committee notes from the Senate Committee on Industry and Business and also the committee notes from the House Committee on State and Federal Government which considered Senate Concurrent Resolution No. 62, photocopies of which are enclosed for your information. It does appear that one of the considerations of the Senate Committee was that this amendment would allow the sale of the securities held by the State Land Department at a loss.

"In view of the fact that this is a constitutional amendment which must be approved by the people, the legislative intent behind Senate Concurrent Resolution No. 62 and the actual wording contained in that resolution, we would like your office to render an Attorney General's Opinion as to whether or not it is permissible for the State Land Department to sell securities held in its investment portfolio at a loss. Thank you."

Prior to determining the effect of the above mentioned constitutional amendment, it is helpful to examine the constitutional provisions as they appear prior to the constitutional amendment and the possible interpretation that may have been placed on those provisions.

The relevant constitutional provisions, prior to their amendment, read as follows:

> "SECTION 153. All proceeds of the public lands that have heretofore been, or may hereafter be granted by the United States for the support of the common schools in this state; all such percentum as may be granted by the United States on the sale of public lands; the proceeds of property that shall fall

to the state by escheat; the proceeds of all gifts and donations to the state for common schools, or not otherwise appropriated by the terms of the gift, and all other property otherwise acquired for common schools, shall be and remain a perpetual fund for the maintenance of the common schools of the state. It shall be deemed a trust fund, the principal of which shall forever remain inviolate and may be increased but never diminished. The state shall make good all losses thereof." (emphasis added)

"SECTION 156. The superintendent of public instruction, governor, attorney general, secretary of state and state auditor, shall constitute a board of commissioners, which shall be denominated the 'Board of University and School Lands,' and subject to the provisions of this article and any law that may be passed by the legislative assembly, said board shall have control of the appraisement, sale, rental and disposal of all school and university lands, and shall direct the investment of the funds arising therefrom in the hands of the state treasurer, under the limitations in section 160 of this article."

"SECTION 159. All land, money or other property donated, granted or received from the United States or any other source for a university, school of mines, reform school, agricultural college, deaf and dumb asylum, normal school or other educational or charitable institution or purpose, and the proceeds of all such lands and other property so received from any source, shall be and remain perpetual funds, the interest and income of which, together with the rents of all such lands as may remain unsold shall be inviolably appropriated and applied to the specific objects of the original grants or gifts. The principal of every such fund may be increased but shall never be diminished, and the interest and income only shall be used. Every such fund shall be deemed a trust fund held by the state, and the state shall make good all losses thereof." (emphasis added)

"SECTION 162. The moneys of the permanent school fund and other educational funds shall be invested only in bonds of school corporations or of counties, or of townships, or of municipalities within the state, bonds issued for the construction of drains under authority of law within the state, bonds of the United States, bonds of the state of North Dakota, or on first mortgages on farm lands in this state to the extent such mortgages are guaranteed or insured by the United States or any instrumentality thereof, or if not so guaranteed or insured, not exceeding in amount one-half of the actual value of any subdivision on which the same may be loaned such value to be determined by board of appraisal of school lands."

In our opinion, these particular constitutional provisions established the following propositions:

1. The corpus of these funds are trust funds. (Sections 153 and 159)

2. The corpus of these funds "may be increased but shall never be diminished". (Sections 153 and 159)

3. The state is in the position of a guarantor. ("The state shall make good all losses thereof." Sections 153 and 159)

4. The investment authority of the Board of University and School Lands is limited. (Section 162)

5. The Board's investment authority may be further limited by legislative enactments. (Section 156)

With the foregoing in mind, we now turn to the problem as to whether or not it would have been permissible to sell securities at a loss, reinvest the proceeds therefrom and amortize the loss sustained on the sale of the original securities from the yield of the newly purchased securities prior to the constitutional amendment. Although there are no North Dakota cases which have dealt specifically with this problem, there is one case that does consider amortization of interest into the permanent fund.

Moses v. Baker (N.D. 1941), 299 N.W. 315, considered the problem of purchasing bonds at a premium along with accrued interest and how such a purchase should be accomplished. After deciding that the payment of a premium along with accrued interest for a bond is permissible, the court went on to say at page 317:

> "The interest accrued on the bonds to date of purchase was a portion of the price the board was required to pay for the bonds. It would be repaid at the next interest payment date, which, in any event, could not be more than six months thereafter. When thus paid, being a part of the purchase price, it properly should be covered into the permanent school fund whence the purchase price came. Hememway v. Hememway, 134 Mass. 446. It is true that this was interest on the bonds and would be repaid as such. But it was interest already earned when the bonds were bought. It was not interest and income within the meaning of those terms as used with respect to the interest and income fund. And this was the legislative thought with respect to this matter for the statute, section 295, Comp. Laws 1913, provides: 'There is hereby annually appropriated such sums as shall be found necessary for the expenses of purchase, and payment of accrued interest at the time of the purchase, of investment bonds or mortgages for the permanent funds under the control of said board, payable from the respective fund for which said purchase is made.

"After all, there should be no difficulty about a matter such as this other than that which arises from the making of bookkeeping entries. Accordingly, the trial court should not have required the auditor to issue her warrant for the amount of the accrued interest drawn on the interest and income fund. This was a part of the purchase price and should have been included with the remainder of the purchase price in the warrant drawn on the permanent fund."

Although this case does say that it is permissible to amortize from the interest on an investment part of the purchase price of a

security, such amortization is limited. That limitation pertains only to accrued interest on the purchase price of an investment as provided in Section 295, Comp. Laws 1913, which presently appears as Section 15-03-16 of the North Dakota Century Code. The holding in that case cannot be broadened to cover the situation of selling securities at a loss, reinvesting the proceeds and amortizing the loss from the yield of the new securities. In fact, such a proposal would appear to have been in violation of the constitution as it appeared prior to 1969.

Schelle v. Foss (S.D. 1957), 83 N.W.2d. 847, considered a plan by South Dakota to sell securities belonging to the permanent school funds of that state at a loss, reinvesting the proceeds on such a discounted sale and amortizing the loss out of the yield of the new securities. They held that such a plan would violate the South Dakota Constitution. Although the case has no binding effect in North Dakota, its reasoning must be given some weight since the South Dakota constitutional provisions under consideration in the case had many of the same provisions of the North Dakota Constitution prior to the 1969 amendment.

Schelle v. Foss, supra, also considered the principle established in Moses v. Baker, supra, and said at page 853:

> "Aside from any consideration of constitutional and statutory differences existing in our state and the states of Nebraska and North Dakota, we believe the sale of school fund securities at a discount involves an entirely different principle than the purchase of such securities at a premium. The payment of a premium arises out of necessity in order to keep trust funds invested. The premium paid merely adds to the net cost of the investment thereby reducing the net income to be realized thereon. The voluntary sale of invested securities at a loss, on the other hand, is proposed by the defendants solely in anticipation of greater returns on the investment. There is no assurance of such eventuality. Furthermore, the sale at discount will necessarily result in depleting the principal funds which can only be restored, in this case, by an unlawful diversion of interest and income."

In considering exactly how the plan would violate the South Dakota Constitution, the court said at page 854:

> "We, furthermore, cannot escape the conclusion that the voluntary sale of invested securities belonging to the permanent school funds at a discount would be an unconstitutional assumption of power. Such sales would constitute an unlawful diminishment of the principal of the funds contrary to the provisions of our Constitution that such money 'shall be and remain a perpetual fund * * *. The principal shall forever remain inviolate, and may be increased, but shall never be diminished * * *.' Such language does not sanction degrees or periods of diminishment.

The reasoning used in this case could easily have been applied to North Dakota's Constitution. Section 153 and Section 159 provided that the funds are trust funds and that the funds "may be increased

but shall never be diminished." Those sections did not appear to "sanction degrees or periods of diminishment" as neither did the South Dakota Constitution. Therefore, the sale of securities at a loss, reinvesting the proceeds and amortizing the loss of the discounted securities from the yield of newly purchased securities would have been a violation of the North Dakota Constitution. This now brings us to a consideration of the mentioned constitutional amendment.

The constitutional amendment provided for the repeal of Sections 159 and 162 and Sections 153 and 156 were amended to read as follows:

> "SECTION 153. All proceeds of the public lands that have heretofore been, or may hereafter be granted by the United States for the support of the common schools in this state; all such percentum as may be granted by the United States on the sale of public lands; the proceeds of property that shall fall to the state by escheat; all gifts, donations, or the proceeds thereof that come to the state for support of the common schools, or not otherwise appropriated by the terms of the gift, and all other property "otherwise acquired for common schools, shall be and remain a perpetual trust fund for the maintenance of the common schools of the state. Only the interest and income of the fund may be expended and the principal shall be retained and devoted to the trust purpose. All property, real or personal, 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. Should a gift be made to an institution for a specific purpose, without designating a trustee, such gift may be placed in the institution's fund; provided that such a donation may be expended as the terms of the gift provide.
>
> "The interest and income of each institutional trust fund held by the state shall, unless otherwise specified by the donor, be appropriated by the legislative assembly to the exclusive use of the institution for which the funds were given" (emphasis added)
>
> "SECTION 156. The superintendent of public instruction, governor, attorney general, secretary of state and state auditor shall constitute a board of commissioners, which shall be denominated the 'board of University and School Lands', and, subject to the provisions of this article and any law that may be passed by the legislative assembly, said board shall have control of the appraisement, sale, rental, and disposal of all school and university lands, and proceeds from the sale of such lands shall be invested as provided by law." (emphasis added)

The House Committee on State and Federal Government considered Senate Concurrent Resolution No. 62 and their intent as to this Resolution does appear in the "Summary of Committee Discussion-Purpose of Amendments" which reads as follows:

> "The committee felt it was wiser to sell old bonds at a loss and reinvest and make more than to hold the bonds until maturity and thus lose so much income for the state. Rep. Thompson said the state could realize about $480,000 more if the low income bonds were sold and the money reinvested."

Although the above quoted language gives us an idea as to what was the intent behind the change, an examination of the constitutional change appears to establish the following:

1. The amendment still provides that these funds are to be treated as "perpetual trust funds". (Section 153)

2. The amendment deleted the phrase that these funds are to remain "inviolate and may be increased but shall never be diminished".

3. The amendment also deleted the language that "the state shall make good all losses thereof", thereby, taking the state out of the position of a guarantor.

4. The constitutional limitation as to investment previously contained in Section 162 has been repealed, and Section 156 now provides that the "proceeds from the sale of such lands shall be invested as provided by law." This establishes that the legislature must determine what types of securities the board may invested in, rather than making it a part of the Constitution.

In view of the foregoing, it appears that the intent of Senate Concurrent Resolution No. 62 (to permit the sale of old securities at a loss and reinvest the proceeds at a higher rate of interest) was accomplished along with a liberalization of investment authority. However, there is no mention as to how this is to be accomplished in either the Constitution or the statutes. Section 15-03-04 and Section 21-10-07 of the North Dakota Century Code do not direct themselves as to how the Board of University and School Lands is to make investments, but those sections merely direct themselves to the type of investments permissible by the board.

Since there is no direct authority for the Board of University and School Lands to sell securities at less than face value or purchase price, the question turns upon whether or not such implied authority exists. That particular question is answered in the affirmative. Fuller v. Board of University an School Lands (ND 1913), 129 N.W. 1029, has long been cited for the proposition that the Board of University and School Lands is vested with discretion in the performance of its duties.

A similar question was considered In Re Montana Trust and Legacy Fund (Mont. 1964), 388 P. 2d. 366. The Montana Supreme Court issued an advisory opinion concerning its school funds and rejected the argument that no implied authority exists in a state agency to transfer, before maturity, securities or that no implied authority exists to sell securities at less than face value or purchase price. At Page 370 of that decision they said:

> "That is a principle to which we do not subscribe, for we are aware of no cogent reason why the general authority of investment and administration of funds should not include the authority to administer investments in a manner consistent with the realities of the securities market. See 2 Scott, Trusts, Sec. 186 (2d. ed. 1956). Indeed, we should be most reluctant to announce a rule which would preclude the appropriate state authorities from being able to take advantage of a 'better deal,' so long as it may likewise be classed as a safe and conservative investment. Because of the constitutional and statutory limitations respecting the type of securities which may be purchased, we do not believe our position throws the door open to dangerous speculation.
>
> "The same reasoning is applicable to the question of whether implied authority exists to sell securities in the Trust and Legacy Fund at less than face value or purchase price, as distinguished from the related question of whether they may be sold at all before maturity, when such authority is neither expressly granted nor withheld. We conclude that such implied authority does exist and, because of the absence of any inconsistent constitutional or statutory provisions * * * likewise conclude that securities therein may be sold at less than face value or purchase price."

In view of Fuller v. Board of University and School Lands, supra, and the above quoted language, it is our opinion that the Board of University and School Lands does have implied authority to sell securities prior to their maturity date and for less than their face value or purchase price. This leads to the next question as to how this is to be accomplished.

Section 153 of the North Dakota Constitution still makes it quite clear that these funds are "perpetual trust funds". Since such is the case, the intent of the frames of Senate Concurrent Resolution No. 62 can hardly be construed as a meaning that securities may be sold at a loss without any consideration as to the recoupment of that loss. It is crucial to distinguish between a permanent loss and a temporary loss of permanent funds. In the administration of these "perpetual trust funds", a permanent loss of such funds cannot be condoned. The framers of Senate Concurrent Resolution No. 62, we believe, did not intend to establish a rule which would defeat the concept of "perpetual trust funds". In today's securities market there are varying yield values of different securities. In the administration of these funds it may be prudent at times to take a temporary loss of permanent funds in return for a greater realization of income. However, this greater realization of income must be made in view of the necessity of allocating a portion of that increased income to the restoration of lost principle. Therefore, we are of the opinion that when securities are sold at a loss and the proceeds therefrom used to purchase higher incoming yielding securities, the income gain resulting from such a sale and purchase must be used to restore the temporary loss of permanent funds.

This leads us to the next issue as to whether or not income gain can be used to restore a temporary loss of permanent funds. Would such a plan violate the last paragraph of Section 152, quoted previously, or

Section 154 of the North Dakota Constitution? Section 154 reads:

> "SECTION 154. The interest and income of this fund together with the net proceeds of all fines for violation of state laws and all other sums which may be added thereto by law, shall be faithfully used and applied each year for the benefit of the common schools of the state, and shall be for this purpose apportioned among and between all the several common school corporations of the state in proportion to the number of children in each of school age, as may be fixed by law, and no part of the fund shall ever be diverted, even temporarily, from this purpose or used for any other purpose whatever than the maintenance of common schools for the equal benefit of all the people of the state; provided however, that if any portion of the interest or income aforesaid be not expended during any year, said portion shall be added to and become a part of the school fund."

In Re Montana Trust and Legacy Fund, supra, dealt specifically with this issue and established what we believe to be the proper rule:

> "In our opinion, this mandate is satisfied whether the interest is devoted directly or indirectly to the maintenance and perpetuation of those institutions. In other words, we do not believe the constitutional requirement is violated by an allocation of some interest toward restoration of temporary loss of principal when the overall effect of the plan is to improve the income posture of the funds. Such allocation of income is certainly, in the long run, in the interest of maintaining and perpetuating the institutions for whose benefit the funds exist."

When Section 153 and Section 154 speak in terms of diversion and allocation of income and interest for those educational and charitable institutions, it means an allocation or diversion noneducational or noncharitable purpose. It is directed at a plan drawn in the best interest of those institutions. It is our opinion that the use of an income gain to restore a temporary loss of permanent funds would not violate either Section 153 or Section 154 of the North Dakota Constitution.

The largest portion of the corpus of these funds is either the land or the proceeds from the sale of such land which was granted to this state by the Enabling Act of 1889. An examination of that congressional enactment appears to contain no prohibition against the plan of selling securities at a loss and recouping that temporary loss from the income gain of the higher yielding securities. However, Section 16 of the Enabling Act provides:

> "16. That 90,000 acres of land, to be selected and located as provided in section 10 of this act, are hereby granted to each of said states except to the state of South Dakota, to which 120,000 acres are granted for the use and support of agricultural colleges in said states, as provided in the acts of congress making donations of lands for such purposes." (Emphasis added)

The acts of congress referred to in Section 16 is an 1862 Congressional Enactment, Chap. 130, 12 Stat. 503, July 2, 1862, 7 U.S.C.A. Sections 301-308. 7 U.S.C.A. Section 304 reads as follows:

> "All moneys derived from the sale of lands as provided in section 302 of this title by the States to which lands are apportioned and from the sales of land scrip provided in said section shall be invested in bonds of the United States or of the States or some other safe bonds; or the same may be invested by the States having no State bonds in any manner after the legislatures of such states shall have assented thereto and engaged that such funds shall yield a fair and reasonable rate of return, to be fixed by the State legislatures, and the principal thereof shall forever remain unimpaired: Provided, that the moneys so invested or loaned shall constitute a perpetual fund, the capital of which shall remain forever undiminished (except so far as may be provided in section 305 of this title), and the interest of which shall be inviolably appropriated, by each State which may take and claim the benefit of Sections 301-305, 307 and 308 of this title, to the endowment, support, and maintenance of at least one college where the leading object shall be, without excluding other scientific and classical studies and including military tactics, to teach such branches of learning as are related to agriculture and the mechanic arts, in such manner as the legislatures of the States may respectively prescribe, in order to promote the liberal and practical education of the industrial classes in the several pursuits and professions in life." (emphasis added)

It is quite clear that this grant was made under certain conditions and the first paragraph of Section 305 makes it quite clear as to what is the status of these permanent funds:

> "If any portion of the fund invested, as provided by Section 304 of this title, or any portion of the interest thereon, shall by any action or contingency, be diminished or lost, it shall be replaced by the state to which it belongs, so that the capital of the fund shall remain forever undiminished; * * *" (emphasis added)

The above quoted language is explicit. It specifically provides that the principal of funds created by the sale of lands granted to North Dakota under Section 16 of the Enabling Act "shall forever remain unimpaired" and "undiminished". Since this language is so clear, it is our opinion that securities purchased with these funds may not be sold for less than the purchase price or face value.

In closing, it is the opinion of this office that the 1969 Constitutional Amendment did accomplish the intended purpose as stated in your letter. The repeal of Sections 159 and 162 and the amendment of Section 153 and Section 156 extinguished any constitutional impediments against selling securities at less than face value or purchase price so long as such loss is only temporary and can be recouped. However, that constitutional amendment in no way affects federal legislation still in full force and effect. Therefore, securities purchased with proceeds derived from the sale

of lands granted under Section 16 of the Enabling Act (which pertain to North Dakota State University only) cannot be sold for less than face value or purchase price.

I hope the foregoing adequately answers your inquiry.

Very truly yours,

ALLEN I. OLSON

Attorney General