

To: The Honorable Carol Springer
State Treasurer

December 8, 2000
Re:Disposition of Income from
State Trust Lands

Issue Presented

Since statehood, Arizona statutes have allowed rental proceeds and interest earned on the sale of State trust lands to be spent for the benefit of trust beneficiaries. You have asked if the Arizona Constitution and the Enabling Act instead require that all such monies generated from the rental, sale, or use of State trust lands be deposited in a permanent fund or investment.

Summary Answer

The Arizona Constitution and Enabling Act do not require all monies generated from the rental, sale, or use of State trust lands to be deposited in a permanent fund. The statutes permitting rental proceeds and the interest earned on the sale of State trust lands to be spent for the benefit of the trust beneficiaries comply with the Constitution and Enabling Act.

Background

The Arizona-New Mexico Enabling Act, which is the federal law authorizing the creation of the States of Arizona and New Mexico, granted to the State of Arizona more than ten million acres of land in trust for designated beneficiaries. Act of June 20, 1910, ch. 310, 36 Stat. 557, 568-579 ("Enabling Act"), §§ 24, 25. The Enabling Act granted most of the land, originally more than eight million acres, in trust for the benefit of the common schools. *Id.* § 24. The remainder was granted in trust for the benefit of universities and other public institutions. In addition to designating certain lands as trust lands and identifying the beneficiaries, the Enabling Act established requirements for the lease and sale of trust land to ensure that the land is managed in a manner that benefits the trust beneficiaries. See *Kadish v. State Land Dep't*, 155 Ariz. 484, 487, 747 P.2d 1183, 1186 (1987) (restrictions ensured States would not dissipate trust assets).

The Arizona Constitution expressly accepted the requirements of the Enabling Act. Ariz. Const. art. XX, § 12 ("The State of Arizona and its people hereby consent to . . . the provisions of the Enabling Act . . . concerning the lands thereby granted or confirmed to the State). Arizona's Constitution also incorporated some parts of the Enabling Act. For example, much of Article X, which governs State and school lands, incorporates parts of the Enabling Act. Article XI, concerning education, also includes provisions concerning trust lands.

In 1915, the Legislature enacted the State Lands Code, which created the State Land Department ("Land Department") and established a system for managing State trust lands and using funds generated by the lands for the benefit of the trust beneficiaries. 1915 Ariz. Sess. Laws, 2nd S.S., Ch. 5. These statutes established separate funds for each of the beneficiaries. Essentially the same structure remains in current statutes. See A.R.S. §§ 37-521 (common schools);

-522 (universities); -523 (normal schools); -524 (agricultural and mechanical schools and the school of mines); -525 (other State institutions). For each of the funds, the statutes direct the deposit in the permanent fund of the "proceeds of the lands," as well as the proceeds of the sale of timber, mineral, gravel, and other natural products of the land. (The permanent common school fund also includes certain monies resulting from the sale by the federal government of public lands in the State.) See Enabling Act § 27; A.R.S. § 37-521(A)(6). The statutes direct that rental proceeds, interest, and distributions from the permanent fund may be used for the trust beneficiaries.

From 1978 through the end of fiscal year 1999, the permanent fund grew from \$100 million to \$932.5 million. ⁽¹⁾ 1998-99 Ariz. State Land Dept. Ann. REP. at 10 ("Annual Report"). The expendable fund revenues in fiscal year 1999 totaled \$85.6 million, of which \$65.8 million were investment earnings from the permanent fund. *Id.* at 12. The Legislature appropriates these expendable fund monies to schools and other trust beneficiaries to pay for various costs necessary for their operations. *Id.* at 9.

Analysis

A. The Constitution and the Enabling Act Do Not Require That All Moneys Generated by State Trust Lands Be Deposited in a Permanent Fund.

The Enabling Act, as originally enacted, did not require that all revenues generated by State trust land be deposited in the permanent fund. Paragraph 7 of section 28 of the Enabling Act provided in part:

A separate fund shall be established for each of the several objects for which the said grants are hereby made or confirmed, and whenever any moneys shall be in any manner derived from any of said land the same shall be deposited by the State treasurer in the fund corresponding to the grant under which the particular land producing such moneys was by this Act conveyed or confirmed. No moneys shall ever be taken from one fund for deposit in any other, or for any object other than that for which the land producing the same was granted or confirmed. The State treasurer shall keep all such moneys invested in safe, interest-bearing securities

Enabling Act, § 28 (amended 1957).

Another section of the Enabling Act provided that the lands are:

held in trust, to be disposed of in whole or in part only in manner as herein provided and for the several objects specified in the respective granting and confirmatory provisions, and that the natural products and money proceeds of any said lands shall be subject to the same trusts as the lands producing the same.

Enabling Act, § 28, paragraph 1.

At Arizona's constitutional convention, delegates debated whether the Enabling Act

required rental proceeds to be deposited in a permanent fund. Records of the Constitutional Convention (ed. John S. Goff) at 846-47, 945-47. The drafters of the Constitution concluded that rental proceeds could be spent for the benefit of the trust beneficiaries and incorporated this concept in two separate sections of Arizona's Constitution. Article XI, Section 8, which as originally approved, read in part:

The income derived from the investment of the permanent State school fund, *and from the rental derived from school lands*, with such other funds as may be provided by law shall be apportioned annually to the various counties of the State in proportion to the number of pupils of school age residing therein.

(amended 1964) (Emphasis added.)⁽²⁾ Similarly, section 10 of that article provides:

The revenue for the maintenance of the respective State educational institutions shall be derived from the investment of the proceeds of the sale, *and from the rental of such lands* as have been set aside by the Enabling Act approved June 20, 1910, or other legislative enactment of the United States, for the use and benefit of the respective State educational institutions. . . .

(Emphasis added.)

The drafters of Arizona's Constitution also incorporated the language from paragraphs 1 and 7 of section 28 of the Enabling Act as Article X, sections 1 and 7 respectively. Because the Constitution expressly permits the expenditure of rental proceeds in Article XI, it necessarily follows that Article X, sections 1 and 7 did not require that *all* revenues from State trust lands be deposited into a permanent fund. See *Kilpatrick v. Superior Court*, 105 Ariz. 413, 419, 466 P.2d 18, 24 (1970) (different parts of the Constitution are to be read as part of a whole and harmonized).

Moreover, although no Arizona court has addressed the issue, the New Mexico Supreme Court concluded that New Mexico's Enabling Act, which was identical to Arizona's, did not require rental proceeds to be placed in a permanent fund. *State v. Llewellyn*, 167 P. 414 (N.M. 1917), *cert. denied*, 245 U.S. 666 (1917). The court in *Llewellyn* noted that the Enabling Act's requirement that the State Treasurer invest moneys "was directed . . . to the moneys derived from the sale of the lands granted to the State or to the natural products thereof, such as coal, timber, stone, etc., and that it has no application to moneys derived from the rental of these lands." *Id.* at 422. Thus, the language in the original Enabling Act never required that all proceeds from State trust lands be deposited in a permanent fund.⁽³⁾ Instead, the Enabling Act attempted to ensure that the beneficiaries benefit from the trust lands.

A constitutional amendment referred by the Arizona Legislature (Sen. Con. Res. 1007, 43rd Legis., 2nd Reg. Sess. (1999)) and approved by the voters in 1998 ("Proposition 102") did not change any requirements regarding what must be deposited in a permanent fund. Ariz. Secretary of State, 1998 Ballot Propositions For The General Election of Nov. 3, 1998 at 18-25 (1998) ("1998 Publicity Pamphlet"). Proposition 102 amended Article X, Section 7 to expand the investment options of the permanent fund beyond safe, interest-bearing securities. *Id.* This amendment also inserted the word "permanent" to modify "fund" in Article X, Section 7, so that section now provides in part:

Whenever any monies shall be in any manner derived from any of said lands, the same shall be deposited by the State treasurer in the permanent fund corresponding to the grant under which the particular land producing such monies

was, by the Enabling Act, conveyed or confirmed.

Id. at 19.

Viewed in context and in a manner consistent with other constitutional provisions, this change clarified that the investment procedures outlined in Article X, Section 7 applied only to the permanent fund, but did not change whether revenues generated from the trust land must be deposited in the permanent fund. This conclusion is supported by the language of the measure and the legislative history. Nothing in the legislative history or in the publicity pamphlet suggested Proposition 102 changed what revenues from the trust land are deposited in to a permanent fund.⁽⁴⁾ 1998 Publicity Pamphlet. Instead, the measure was described as expanding investment options for the permanent fund. See *id.* at 18-20. Staff of Arizona House of Representatives Bill Summary, S. Con. Res. 1007, 43rd Legis., 2nd Reg. Sess. (May 4, 1998); Hearing on S. Con. Res. 1007 (1998), before the House Committee on Appropriations, 43rd Legis. 2nd Reg. Sess. (April 29, 1998). Additionally, although Proposition 102 amended Article XI, § 8, it did not delete the constitutional provision that allows schools to spend rental proceeds, rather than deposit them in the permanent fund. 1998 Publicity Pamphlet at 21. This, again, supports the conclusion that Proposition 102 did not require that all revenues be deposited in the permanent fund, but rather just expanded the options for the investment of the permanent fund and the requirements for distributions from the permanent fund.

B. The Statutes Permitting Expenditure of Rental Proceeds and Interest on Sale Proceeds Comply with the Constitution and the Enabling Act.

The Legislature has permitted rental proceeds and interest on sales to be spent by trust beneficiaries rather than deposited in the permanent fund. As described above, Arizona's Constitution expressly permits the expenditure of rental income, Ariz. Const., art. XI, § 8, and the New Mexico Supreme Court approved the expenditure of rental proceeds from State trust lands. *Llewellyn*, 167 P. at 414. The Arizona Constitution also permits the expenditure of the investment of sale proceeds, Ariz. Const. art. XI, § 10. The expenditure of interest income on sales is consistent with these constitutional provisions.

The statute directing the deposit of monies received by the State distinguishes principal from rental proceeds and interest as follows:

1. The unexpendable principal of monies received from federal land grants shall be placed in separate funds and the account of each such separate fund shall bear a title indicating the source and the institution or purpose to which such fund belongs.
2. The interest, rentals and other expendable money received as income from federal land grants shall be placed in separate accounts, each account bearing a title indicating the source and the institution or purpose to which the fund belongs. Such expendable monies shall be expended only as authorized, regulated and controlled by the general appropriation act or other act of the legislature.

A.R.S. § 35-142(A)(1),(2).

The Legislature's distinction between principal and interest is consistent with the purpose of the permanent fund and the related constitutional requirements. The permanent fund consists of revenues "earned from the sale of State Trust land and the sale of minerals and natural products such as sand and gravel, water and fuelwood." Annual Report at 10; see also *Llewellyn*, 167 P. at 422 (investment requirement applies to money "derived from the sale of the lands granted to the State or to the natural products thereof"). When deposited in the permanent fund, the sales revenues continue to earn money for the beneficiaries, "in essence replacing the value of Trust lands or resources that were sold or removed." Annual Report at 10.

Unlike the sales price, the interest on the sale does not replace the value of the trust land. Rather, the interest on the sale is income earned on the sales price. Moreover, in a sale on terms, the Enabling Act and the Constitution prohibit title to the land from transferring to the purchaser until the State receives the full sales price. See Enabling Act, § 28, ¶4 (" . . . the legal title shall not be deemed to have passed until the consideration shall have been paid"); Ariz. Const. art. X, § 4 (same language as Enabling Act). For these reasons, the interest earned on sales of trust land is income that, under the Constitution and Enabling Act, may be spent for the immediate benefit of trust beneficiaries, just as rental income and investment earnings from the permanent fund are spent for trust beneficiaries.

Conclusion

The Enabling Act and the Constitution do not require that all monies generated from State trust lands be deposited in the permanent fund. The statutes permitting the trust beneficiaries to use rental proceeds and interest on sales of State trust lands do not violate the State Constitution or the Enabling Act.

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Attorney General

1. The State's Permanent Land Fund consists of the separate funds for the designated trust beneficiaries. See Ariz. Att'y Gen. Op. I99-008.
2. The 1964 amendment to Article XI, Section 8 provided for apportionment of income derived from permanent State school fund investments "only for common and high school education in Arizona, and in such manner as may be prescribed by law." Ariz. Const. art. XI, § 8 (amended 1998).
3. Congress deleted paragraph 7 of section 28 from the Enabling Act in 1957, Pub. L. No. 85-180, 17 Stat. 457 (1957), and no subsequent amendments to the Enabling Act address what must be deposited in a permanent fund. Your opinion request specifically mentioned section 25 of the Enabling Act, which governs lands designated to repay certain county bond debt. Section 25 provides that after the payment of those debts the "remainder of lands and the proceeds of sales thereof shall be added to and become part of the 'permanent school fund'." Enabling Act, § 25. This ensures that the land and proceeds of sales of the land remain part of the permanent school fund, but does not address the expenditure of rental proceeds and interest income for the trust beneficiaries.

4. ⁴ See *Bussanich v. Douglas*, 152 Ariz. 447, 450-51, 733 P.2d 644, 647-48 (1986) (purpose of amendment can be ascertained from publicity pamphlets and arguments supporting constitutional amendment).

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