

## E. Trust Land Management in Montana

Montana's trust lands comprise over 5 million acres of surface and 6.2 million acres of subsurface lands. These lands are predominantly found in a checkerboard pattern with a few consolidated areas that resulted from post-statehood exchanges, foreclosures, and the establishment of national parks and forests.

### 1. Montana's Land Grant

Montana was admitted as a state under the Omnibus Enabling Act of 1889 (Enabling Act),<sup>1</sup> along with Washington, North Dakota, and South Dakota. Although Montana was prepared for admission to the union in 1884, Congress did not act on its request until 1889 due to concerns over maintaining the balance between democratic and republican representatives in Congress. Upon admission, Congress granted each state sections sixteen and thirty-six from each township for support of the "common schools." Montana currently retains about 90 percent of its original land grant of 5.7 million acres.

In addition to the section sixteen and thirty-six lands, Montana received additional land grants for specific public institutions – seventy-two sections exclusively for university purposes; 100,000 acres each for a school of mines and normal schools; 50,000 acres for agricultural schools; 50,000 for deaf and dumb asylum school; and 150,000 acres for public buildings. The state received an additional 100,000 acres under the Morrill Acts of 1862 and 1890 for the benefit of higher education.

### 2. Enabling Act and Constitutional Requirements

Under the terms of the Enabling Act, Montana is permitted to:

- "Dispose of" the lands for a minimum price only at advertised public sale;
- Exchange lands where the lands have equal value and are as nearly as possible of equal area;
- Lease lands for a term of years; and,
- Grant easements or other rights.

The Enabling Act also required the state to place revenues from the sale of lands in a permanent fund set up solely for the benefit of the institution for which the lands were granted and requires the state to obtain "full market value" for the disposal of any estate or interest in trust lands.<sup>2</sup>

Montana's Constitution mirrors the Enabling Act requirements by directing the state government to hold the public lands of the state "in trust for the people" to support schools.<sup>3</sup> The Constitution also requires proceeds from land sales to be placed in a permanent fund, to be held "forever inviolate and protected against loss or diversion," and that the lands be classified "in a manner provided by law."<sup>4</sup> It also creates and designates the composition of the state Board of Land Commissioners (Land Board), and grants the Land Board authority to "direct, control, lease, exchange, and sell school lands...under regulations and restrictions as may be provided by law."<sup>5</sup>

While the beneficiaries of Montana's trust are widely presumed to be the public institutions for which lands were granted by the Enabling Act and subsequent legislation, Montana's Constitution imposes a co-existing public obligation on the state as a land manager. Article IX of Montana's Constitution charges the state government with protecting and enhancing the inalienable right of all Montanans to a clean and healthful environment.<sup>6</sup> The combination of this constitutional right with

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<sup>1</sup> Montana Enabling Act, 25 Stat. 676 (1889).

<sup>2</sup> *Id.* at § 11. See discussion *infra* regarding the state's land banking program, which allows proceeds from the sale of land to be used to purchase other lands.

<sup>3</sup> MONT. CONST. Art. X.

<sup>4</sup> *Id.* at Art. X, §§ 2-3.

<sup>5</sup> *Id.* at Art. X, § 4.

<sup>6</sup> *Id.* at Art. IX.

the state's well-established duties to manage the grant of lands as a trust has shaped Montana's approach to trust land management. One of the primary effects of this constitutional provision is the application of the Montana Environmental Policy Act (MEPA) to state trust lands, which requires state agencies to identify the environmental impacts of proposed actions.<sup>7</sup>

### 3. Montana's Trust Responsibility

The courts have interpreted Montana's Enabling Act and Constitution to impose a trust responsibility, with Montana's Land Board functioning as the "trustee" of this trust.<sup>8</sup> Based on this trust responsibility, the courts have held that:

- Although the legislature may establish the definition of full market value, the state must actually receive full market value; as a result, a statute allowing the state to issue free firewood permits on state lands violated the trust responsibility because agency failed to capture value for valuable wood.<sup>9</sup>
- Trust lands are subject to the requirements of MEPA.<sup>10</sup>
- The state as trustee has the discretion to accept a lesser bid for a state school land lease, despite the requirement to obtain "full market value" from dispositions, since the trustee's discretion permits "getting the best lessees possible" to ensure "maximum return with the least injury occurring to the land."<sup>11</sup>

### 4. Governance of Trust Lands in Montana

The Land Board is made up of the top five elected officials in the state – the Governor, Secretary of State, Attorney General, Superintendent of Public Instruction, and State Auditor – and serves as the trustee in the management of Montana's trust lands. The Land Board's role is to exercise general authority, direction, and control over the care, management, and disposition of state lands.<sup>12</sup>

The Trust Land Management Division (TLMD), one of seven divisions within the Montana Department of Natural Resources and Conservation (DNRC), is charged with executing the direction of the Land Board in the selection, exchange, classification, appraisal, leasing, management, sale, or other disposition of state lands.<sup>13</sup> The DNRC director is appointed by the Governor, subject to Senate confirmation, and serves at the Governor's pleasure.<sup>14</sup> The TLMD is divided into four primary management areas: Agriculture and Grazing, Forest, Minerals, and Real Estate. Most dispositional transactions undertaken by DNRC (e.g., easements, certain leases, exchanges and sales) must be finally approved by the Board.

TLMD receives 39 percent of its funding from trust fund revenues, 33 percent from timber sales, 21 percent from forest improvement fees, and the remaining 6 percent from resource development funds. The state's practice of using trust revenues to cover the agency's administrative

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<sup>7</sup> See MONT. CODE. ANN. § 75-1-101 et seq.

<sup>8</sup> State ex rel. Thompson v. Babcock, 409 P.2d 808, 812 (Mont. 1966) (Board of Land Commissioners is the trustee of state lands); see also State ex rel. Gravelly v. Stewart, 137 P. 854 (Mont. 1913) (Board of Land Commissioners acts as trustee). However, although the BLC acts as trustee for purposes of the administration of the lands, the lands are held in trust by the state, such that the state and the legislature are also in the position of a trustee. See *Toomey v. State Board of Land Commissioners*, 81 P.2d 407, 414 (Mont. 1938) (state of Montana is the trustee); *Strandberg v. Board of Land Commissioners*, 307 P.2d 234, 236 (Mont. 1957) (legislature is the trustee).

<sup>9</sup> *Montanans for the Responsible Use of the School Trust v. State ex rel. Board of Land Commissioners*, 983 P.2d 937 (Mont. 1999).

<sup>10</sup> *North Fork Preservation Ass'n v. Department of State Lands*, 778 P.2d 862, 866-67 (Mont. 1989).

<sup>11</sup> State ex rel. Thompson v. Babcock, 409 P.2d 808, 811-12 (Mont. 1966).

<sup>12</sup> MONT. CONST. Art. X § 4; MONT. CODE. ANN. §§ 2-15-201, 77-1-202.

<sup>13</sup> MONT. CODE. ANN. § 77-1-301.

<sup>14</sup> *Id.* at §§ 2-15-301, 2-15-111.

costs (as occurs in several other Western states) was questioned during an audit in 2004, but was subsequently confirmed by the state legislature in 2005.<sup>15</sup>

### 5. Trust Land Management in Montana

The “guiding principle” for the administration of Montana’s trust lands is that

[the] lands and funds are held in trust for the support of education and for the attainment of other worthy objects helpful to the well-being of the people of this state as provided in the Enabling Act. The board shall administer this trust to secure the largest measure of legitimate and reasonable advantage to the state.<sup>16</sup>

The legislature has directed the Land Board and DNRC to manage trust lands under a “multiple-use management concept” that balances land uses with “the needs of the people and the beneficiaries of the trust.”<sup>17</sup>

DNRC’s trust land management activities can be broken into three general types of activities: surface uses, subsurface uses, and land sales and other uses.

#### a. Surface Uses

Surface uses provide the largest source of revenue from Montana trust lands. Almost 99 percent of the lands in the state are leased or managed for agriculture, grazing, and timber production; in combination, these uses generated nearly 60 percent of the state’s management revenue in 2003.

Agricultural, grazing, and other leases are granted to lessees through a competitive bidding process for terms of five to ten years, although the state reserves the right to reject the high bid for reasons stated in writing.<sup>18</sup> Agricultural lease rates are based on a crop-share formula or cash value, while grazing rates are derived from a defined animal-unit-month (AUM) unit value on the basis of carrying capacity. The state manages its forest land under sustained yield principles as set forth in the State Forest Land Management Plan (SFLMP) and Montana’s administrative rules. The SFLMP is a programmatic environmental impact statement which established a general management philosophy and specific resource standards, pursuant to a yield amount established by statute.<sup>19</sup> The current annual sustained yield harvest requirement is 53.2 MMBF, which constitutes about 5 percent of timber volume harvested in the state.

The Real Estate Management Bureau (REMB) administers all activities on lands that do not have a primary surface use for agriculture, grazing, or timber management. The residential, commercial, industrial, and conservation uses for trust lands are developed in accordance with the Real Estate Management Plan. REMB also manages all secondary activities on lands classified as grazing, agriculture, or timber. Secondary uses are characterized by the state as “licenses.” A license may be issued for temporary storage of gravel, construction materials, or equipment, for a group activity, for research, for outfitting and other forms of recreation, and for short-term agricultural uses such as grain bins, stockwater reservoirs, or pipelines.

Commercial uses, which exclude agriculture, grazing, mining, single family residences, home sites, and cabin leases, can be solicited by the state and awarded to the highest and best bidder for

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<sup>15</sup> In November, 2004, the Legislative Audit Division of the state of Montana released a report questioning the constitutionality of the legislature’s authorization for DNRC to cover the administrative costs of trust management from certain trust revenues. See Audit Report No. 04-17, *Report to the Legislature, Financial-Compliance Audit For the Two Fiscal Years Ended June 30, 2004 Department of Natural Resources and Conservation* (2004).

<sup>16</sup> MONT. CODE. ANN. § 77-1-202.

<sup>17</sup> *Id.* at § 77-1-203.

<sup>18</sup> *Id.* at §§ 77-6-101 et seq.

<sup>19</sup> *Id.* at §§ 77-1-223 to 224.

up to a ninety-nine year lease term.<sup>20</sup> The state also offers licenses for specific types of uses such as recreation, hunting and fishing, and conservation uses.<sup>21</sup>

#### *b. Subsurface Uses*

The state may lease trust lands for mining prospecting and activities, including navigable stream beds and other reserved lands or rights for full market value. The primary types of mining activities that occur on trust lands are for oil and gas, coal, and minerals (metalliferous and non-metalliferous). Oil and gas leases are let on a quarterly basis by a competitive, oral bidding process and are awarded to the highest, qualified bidder.<sup>22</sup> Coal leasing may take place upon application or at the initiative of the agency and leases are awarded through a competitive, oral or sealed bidding process.<sup>23</sup> Requests for metalliferous and non-metalliferous leases and licenses are awarded on both competitive and non-competitive basis, with the primary term varying from less than one year to ten years.<sup>24</sup>

Geothermal and hydroelectric resources are also available for prospecting, exploration, and production.<sup>25</sup> Geothermal resources are leased by competitive bid by sealed bid for a ten year primary term.<sup>26</sup>

#### *c. Land Sales and Other*

Montana's Land Board is authorized to sell or exchange trust lands, as well as easements or rights-of-way across trust lands. However, the state has generally preferred to retain its ownership in trust lands, and has historically focused on the use of land exchanges to diversify its land base, while utilizing renewable resource leases to generate revenues. Less than 1 percent of Montana's trust land management revenue was generated through the sale of lands in fiscal year 2004; however, as discussed *infra*, the state is currently considering a proposal that would significantly increase land sale activities.

The sale of trust lands takes place at a noticed, public auction. Land is sold to the highest bidder at a minimum value established by the Board after qualified appraisal, with all sales subject to the final approval of the Board. By law, the state retains subsurface rights and generally retains riparian rights to sale property. DNRC is authorized to sell state trust land and use those funds to purchase replacement lands for the trust through a process called "Land Banking."<sup>27</sup> The intent of the Land Banking program is for the state to dispose of scattered tracts of land that generally do not have legal access and that generate substantially less income for the trust than their relative value, or that are difficult for the Department to manage; the Department can then purchase property in larger blocks, land that is contiguous to existing state land or that has legal access, or other land with the potential for increased revenue and more efficient management. The statute limits the amount of land that can be sold to one hundred thousand acres until the program is evaluated by the legislature in 2009. The sale of trust lands takes place at a noticed, public auction.

The Board may also exchange trust lands with governmental or non-governmental entities for lands of equal or greater value as determined by appraisal, income generating potential, and relative parcel size; lands with equivalent navigable or waterway values; or lands that aid consolidation.<sup>28</sup> When an exchange is proposed, the Board is required to notify former and current lessees, hold a

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<sup>20</sup> See *id.* at §§ 77-1-901 et seq.

<sup>21</sup> *Id.* at §§ 77-1-801 et seq.

<sup>22</sup> *Id.* at § 73-3-402; ARM § 36.25.205.

<sup>23</sup> MONT. ADMIN. R. §§ 36.25.301 et seq.

<sup>24</sup> *Id.* at § 36.25.605.

<sup>25</sup> MONT. CODE ANN. § 77-4-101.

<sup>26</sup> MONT. ADMIN. R. § 36.25.404.

<sup>27</sup> MONT. CODE ANN. §§ 77-2-361 to 366.

<sup>28</sup> *Id.* at §§ 77-2-201, et seq.

public hearing in the county where the land is located, and adopt findings of fact to respond to any objections.<sup>29</sup> All exchanges are subject to the final approval of the Land Board.<sup>30</sup>

The Land Board is also authorized to grant easements for public purposes such as schoolhouse sites, parks, community buildings, rights-of-way, or utility uses; but it is limited in its authority to grant easements for conservation purposes.<sup>31</sup> Only the Department of Fish Wildlife and Parks (DFWP) and two specified non-profits may hold a conservation easement over trust lands.<sup>32</sup> The state is not required to advertise the sale of easements for bid, but must receive full compensation which may include in-kind services and materials as payment.<sup>33</sup>

With the growing interest in commercial and residential development on the part of the TLMD, and a growing concern among the public with regard to the loss of recreational access and natural resource use of state lands, the legislature has adopted school trust management programs such as the “land banking” program, that allows the state to sell certain designated lands and use the proceeds to purchase other lands, as well as a statutory program that allows the state to designate ecologically significant trust lands as “natural areas.”<sup>34</sup>

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<sup>29</sup> *Id.* at § 77-2-204.

<sup>30</sup> *Id.* at § 77-2-207.

<sup>31</sup> *Id.* at § 77-2-101.

<sup>32</sup> *Id.* at § 77-2-101(e).

<sup>33</sup> *Id.* at § 77-2-106.

<sup>34</sup> *Id.* at § 76-12-101

**Table V(E): FY 2004 Revenues – Montana DNRC Trust Lands Management Division**

<b>Source</b>	<b>% of Revenue</b>	<b>Receipts</b>
<b>Surface Uses</b>		
Agriculture	20.2%	\$9,331,416
Grazing	9.7%	\$4,494,637
Timber sales	22.9%	\$10,591,657
Forest Improvement Fees	3.3%	\$1,524,822
<b>Total Surface</b>	<b>56.1%</b>	<b>\$25,942,532</b>
<b>Subsurface Uses</b>		
Oil and Gas	23.5%	\$10,895,367
Coal	10.2%	\$4,720,861
Other	0.4%	\$194,759
<b>Total Subsurface</b>	<b>34.2%</b>	<b>\$15,810,987</b>
<b>Sales and Other</b>		
Land Sales	0.0%	\$2,900
Other Leases and Licenses*	5.2%	\$2,410,210
Right of Way	4.6%	\$2,117,993
<b>Total Sales and Other</b>	<b>9.8%</b>	<b>\$4,531,103</b>
<b>Grand Total</b>	<b>100%</b>	<b>\$46,284,622</b>
<b>Trust Land Administration Budget</b>		<b>\$8,800,000</b>

\* Lease and license revenue figures combined for FY 2000-2003

Source: Montana Department of Natural Resources and Conservation FY 2004 Annual Report

#### 6. Trust Revenue Distribution in Montana

There are nine beneficiaries who receive revenues from Montana's trust lands: (1) the common schools; (2) the University of Montana; (3) Montana Tech; (4) Montana State University; (5) the state normal school; (6) the School for the Deaf and Blind; (7) the State Reform School; (8) the state Veteran's Home; and (9) Public Buildings. Each parcel of state trust land is assigned to a specific trust beneficiary and trust account, and each beneficiary has an individual, segregated trust fund account within the permanent fund.

Revenues generated from the trust lands are treated differently depending on the source of income, the beneficiary, and the type of transaction used to generate the revenue. Proceeds from the sale of lands, along with rights-of-way, certain timber sales, and mineral royalties, are treated as "nondistributable" revenues and placed in the permanent fund. The Montana Board of Investments, the state entity responsible for investment of the permanent fund (also known as the "Trust Legacy

Fund”) is constitutionally prohibited from equity investments and emphasizes instead “a diversified portfolio of fixed income securities.”<sup>35</sup> The current balance of the permanent fund in Montana is \$411,173,416. The common schools are the largest single beneficiaries, accounting for about 90 percent of the total land holdings in the trust.<sup>36</sup>

Generally, proceeds from state trust land leases, interest on deferred payments from land sales, interest earned on the permanent funds, and all other actual income are made available for the maintenance and support of such schools and institutions.<sup>37</sup> These funds are referred to as “distributable.”

Montana employs an equalization method of funding public education that provides each school district a base budget and a per student entitlement (direct state aid and local revenue). The state’s general fund currently contributes approximately 38 percent of the entire school budget, with the remainder coming from local property taxes (46 percent) and federal funding (12 percent).<sup>38</sup> The remainder of the funding is provided by 95 percent of the distributable revenues, including interest from the permanent fund.<sup>39</sup> In fiscal year 2004, \$58,378,908 was distributed to the common schools, representing a 4.8 percent contribution to the state’s overall K-12 school budget of \$1.2 billion.

## 7. Recent Developments and Emerging Issues in Montana

### a. Real Estate Management Bureau Programmatic Environmental Impact Statement (PEIS)

The state of Montana is currently engaged in a programmatic planning process for “special uses” (i.e., residential and commercial development) on over five million acres of trust lands. The plan, which is currently under consideration by the Land Board following the completion of a programmatic environmental impact statement (PEIS) by the DNRC, sets forth a process for investigating the commercial, industrial, residential, and conservation development potential of state lands. The PEIS represents a marked departure from Montana’s historical trust management regime, which has focused almost exclusively on natural resource surface management.

The plan relies on a “funnel filter” methodology for identifying and evaluating development opportunities on state trust lands, which involves a progressive analysis of development suitability. This analysis begins with a “physical environment filter” that evaluates physical development constraints, and removes from consideration lands above an identified slope (25 percent), those located within one hundred-year floodplains, and those within designated grizzly bear and bull trout habitat.<sup>40</sup>

The second stage of the “filter” process applies a “transitional filter,” which ranks various state trust land parcels based on the “locational attributes” associated with those parcels.<sup>41</sup> A Geographic Information Systems (GIS) model was used to measure the proximity of each state trust land parcel to transportation infrastructure, existing development, natural amenities, and other factors that studies had shown to be commonly correlated with growth areas and development suitability. These factors were utilized to categorize trust land parcels into high, medium, and low development suitability classes, with the values averaged to determine the final class assigned to each trust land parcel.<sup>42</sup>

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<sup>35</sup> DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION FY 2004 ANNUAL REPORT, 87 (2005) (citing *Fiscal Year 2002 Annual Report*, Montana Board of Investments, at 41).

<sup>36</sup> *Id.* at 84.

<sup>37</sup> Montana Enabling Act, 25 Stat. 676 § 11.

<sup>38</sup> *Education Week*, Editorial Projects in Education, Inc., available at: <http://edcounts.edweek.org>.

<sup>39</sup> ANNUAL REPORT, *supra* note 639, at 84.

<sup>40</sup> *Final Real Estate Management Programmatic Environmental Impact Statement*, Real Estate Management Bureau, Montana Department of Natural Resources and Conservation, 2-18 (November 19, 2004) (hereafter, “PEIS”).

<sup>41</sup> *Id.* at 2-19 to 2-21.

<sup>42</sup> *Id.* at Appendix C.

The third step in the filter process applies a “market filter” that attempts to assess the market demand for development of trust lands over the next twenty years in each land office.<sup>43</sup> The “market filter” utilized an economic study to assess overall population and income trends statewide. A second study then projected expected growth in acreage of residential, commercial and industrial uses on a land office-wide basis using income and population projections. This information was then used to derive estimates of the potential growth that could occur on trust lands based on the ratio of trust land ownership to private land ownership in each region.<sup>44</sup>

Under the plan, project opportunities would be initially evaluated in relationship to the first three filters; this landscape-level analysis would be followed by a project-level analysis of market demand and economic factors, local planning, MEPA analysis, and an analysis and application of other regulatory constraints and requirements in order to identify and evaluate development opportunities.<sup>45</sup>

The draft document originally considered five alternatives which used the filter information to establish acreage ranges for potential development based on how aggressively the agency would move to capture its “proportionate share” of the expected growth in each land office area. These included an aggressive strategy in which the agency would actively seek to capture twice this proportionate share;<sup>46</sup> an active strategy in which it would seek to capture the full proportionate share;<sup>47</sup> and a less active strategy (similar to the current state of affairs) in which the agency would capture approximately half of this share of development.<sup>48</sup>

DNRC received extensive comments on the PEIS from a number of participants, including the Lincoln Institute/Sonoran Institute Joint Venture. Overall, these comments encouraged DNRC to focus its limited resources on a set of lands most “ripe” for development and recommended several ways the agency could use its innovative “filter” to accomplish that goal. Participants suggested that the agency might better meet the needs of the beneficiaries and the public by limiting consideration of lands with outstanding public values (e.g. watershed protection, high fire hazard, key wildlife habitat). They also suggested ways that the agency’s model could predict more accurately where growth should occur in order to enhance both Montana’s communities and revenues to the beneficiaries, and recommended that the agency conduct more sophisticated market projections to support its potential development decisions.<sup>49</sup>

In direct response to the comments of Lincoln Institute/Sonoran Institute Joint Venture and others, the agency prepared an additional alternative (Alternative D) that incorporates several of the above mentioned recommendations. First, it adds endangered species habitat (grizzly bear and bull trout) to steep slopes and floodplains as criteria for designating lands unsuitable for development. Second, it proposes to view lands with development potential with a higher level of scrutiny at the project level, and to incorporate outcome criteria in development proposals in order to ensure quality growth. Finally, even though the PEIS retains the very broad demographic growth projection as its basis for determining its market share, it did include a monitoring protocol that requires plan review if the projected acreage thresholds are reached.<sup>50</sup>

The plan is currently on hold pending the resolution of issues regarding its implementation; however, the Land Board will likely make a decision on the plan in mid-2005.

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<sup>43</sup> *Id.* at 2-21.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 2-19 to 2-25.

<sup>46</sup> *Draft Real Estate Management Programmatic Environmental Impact Statement*, Real Estate Management Bureau, Montana Department of Natural Resources and Conservation, 2-44 (June 21, 2004).

<sup>47</sup> *Id.* at 2-37.

<sup>48</sup> *Id.* at 2-31, 2-50, 2-43. The plan also considered two “conservation” alternatives in which the agency would seek to dispose of approximately half the land proposed for residential development for conservation purposes.

<sup>49</sup> C.f. *Public Comments of Lincoln Institute of Land Policy/Sonoran Institute Joint Venture on the June 21, 2004 Draft Real Estate Management Programmatic Environmental Impact Statement*, Sonoran Institute (Letter Filed August 19, 2004).

<sup>50</sup> PEIS, *supra* note 644, at 4-66.

### *b. Whitefish Planning Process*

Prior to the release of its PEIS, the agency initiated a collaborative, community based land use planning process in the town of Whitefish, Montana, which serves as a “gateway” community to Glacier National Park. Although the Whitefish economy has traditionally been based on the timber and rail industries, the community has grown rapidly over the past few decades and has shifted from a natural resource-based economy to a service-based economy that relies heavily on the “natural amenities” of the area. As a result, property values are skyrocketing, with recent increases ranging from 10-20 percent per year. The state trust lands in the area, currently managed for timber, are thus under increasing pressure for development as well as for the preservation of recreational and conservation uses that contribute significantly to the local economy and its growth potential.

As part of its overall plan to diversify its revenue streams, the state initiated a planning process on thirteen thousand acres of trust lands located within and around the community of Whitefish with the goal of transitioning some of these lands from natural resource production to real estate development. Because the DNRC proposal encompassed such a large area – essentially all of the trust lands in the vicinity of Whitefish – many residents who use these lands for recreation immediately expressed concern with protecting the aesthetic and environmental values that were associated with the lands. Given that all thirteen thousand acres were potentially under consideration for development, there was a tremendous amount of uncertainty and trepidation regarding the agency’s plans for the land. The (reasonable) assumption made by many community members was that any or all of the lands could be at risk for development. Citizens were concerned that a project proponent could come forward at any time, and that the timeframe for the community to propose alternatives could be very short.

Because of the controversy and the high political stakes involved with the potential development of these lands, the Land Board appointed a diverse group of community stakeholders to develop a proposed Whitefish State Lands Neighborhood Plan as a supplement to the Flathead City County Master Plan. The planning process was generally rocky and reflected continued suspicion with regard to the DNRC’s motives. However, the community advisory group eventually identified the trust lands with the highest community value for recreational, wildlife, water quality, and other important ecological features. They also helped to identify which lands were most suitable for development in terms of access, infrastructure, proximity to development, and economic factors. The advisory group attempted to identify strategies that would balance the values, ensure predictable and quality development, and increase revenues to the trust beneficiaries.

The Plan strongly reflects the community’s concerns with the development of these lands, and DNRC has expressed support for the draft plan that resulted from this effort. The Plan allocates only a small amount of land for development in the near term, proposing instead to either develop new revenue generation mechanisms that will increase value to the trust while preserving the lands for traditional uses (such as timber production), or identifying disposition strategies that will result in the conservation of the lands. Ultimately, it appears that the key to the success of the Plan will lie in the implementation. The strategies developed by the group rely heavily on voluntary conservation mechanisms such as conservation easements, conservation buyers, deed restrictions, incentives, and other types of private sector real estate management techniques not commonly used in Montana. At the present time, the state lacks both the experience and statutory authority to fully carry out the Plan. DNRC has expressed willingness to develop the necessary tools in the interests of broadening the options for the management of trust lands across the state.

### *c. Preference Rights Challenge*

Montana’s historic system of granting an absolute preference right to existing grazing lessees was challenged in a recent lawsuit. The case, *Broadbent v. State of Montana ex rel. DNRC, Board of Land Commissioners*, involved the de facto grant of a preference right to an existing lessee who submitted a competitive high bid.<sup>51</sup> The court ruled that the absolute grant of a preference right with

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<sup>51</sup> BDV-2003-361, 1<sup>st</sup> Jud. Dist. Lewis and Clark (2004).

no factual review by the Land Board infringes on the trustee's discretion to grant the lease to the lessee who will act in the best interests of the trust.

The Land Board adopted rules in late 2004 to reinstate the preference right, subject to the Land Board's ultimate approval, and to ensure that, in awarding grazing and other leases, the trustee is able to consider short term revenue opportunities as well as the long term impacts to the trust of good stewardship practices.

#### *d. School Funding*

In 2002, a coalition of school districts, administrators, and educational organizations called the Montana Quality Education Coalition (MQEC) filed a lawsuit charging that the state of Montana is failing to meet its constitutional obligation to provide Montana's children with a quality education. In an April 2004 opinion, District Judge Jeffrey Sherlock of Helena ruled in favor of the plaintiffs holding that the state, through actions of successive legislatures, has not adequately funded schools, and has thus violated the constitutional guarantee of a quality education. The judge ordered the legislature to devise a new funding system based on the "needs and costs" of the public school system and gave lawmakers until October 2005 to put a new system in place.<sup>52</sup>

The case was appealed to the Montana Supreme Court. In November 2004, the Court issued a preliminary order that unanimously upheld the lower court decision, agreeing that the state's education funding system is unconstitutional and directing the state to develop a funding system that is rationally related to the quality of education.<sup>53</sup>

Currently, Montana's public schools are funded by legislative appropriation, with funding based on a combination of local property taxes and state equalization payments. As noted above, trust revenues comprised only around 4.8 percent of the \$1.2 billion appropriated to public schools in 2003. Whatever the outcome of the current budget crisis, it seems quite likely that the Montana legislature will be looking for revenues to fill budgetary gaps in school funding, which could lead to pressure to increase short-term revenues from trust lands.

#### *e. Coal Tax Trust Loan*

The 2001 legislature passed Senate Bill 495, which authorized the DNRC to borrow against future mineral royalties from the Coal Severance Tax Trust Fund in order to increase the balance of the Common Schools Permanent Fund, and consequently increase the amount of distributable interest income available to fund the common schools. Under the direction of the Land Board, the DNRC borrowed \$46,366,904 at a discount rate of 9.85 percent from the Coal Severance Tax Fund and placed it in the Common School Fund in lieu of \$138,894,596 in future net mineral royalties. While the transfer results in increased distributable revenues for the common schools, over the life of the loan the Permanent Fund stands to lose almost \$100 million.

MonTrust, a non-profit citizens group, filed suit in 2002 alleging that the state breached its fiduciary duties. The case, decided in favor of the state at the trial court level, is currently before the Montana Supreme Court.

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<sup>52</sup> Columbia Falls School District v. State of Montana, Case No. BDV-2002-528, 1<sup>st</sup> Jud. Dist. Lewis and Clark (2004).

<sup>53</sup> Order, Columbia Falls School District et al v. State of Montana, Sup. Ct. Mont., No. 04-0390 (2004).