EXHIBIT 1
DATE 3/31/09
SB 300

1R2817

PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

Montana Legislative Services Division
Legal Services Office

January 30, 2009

Senator Robert R. Story, Jr.
President of the Senate
P.O. Box 200500
Helena, Montana 59620-0500

Dear President Story:

I am writing in response to your request for an opinion on the use of potential compensation received by the state for the past use of navigable riverbeds. This letter constitutes my opinion. Your inquiry is apparently based upon PPL Montana, LLC v. State of Montana, Cause No. CDV-2004-846, First Judicial District (2008), which is currently on appeal to the Montana Supreme Court.

On August 28, 2007, the District Court issued a memorandum and order concluding that the Missouri River, the Madison River, and the Clark Fork River are navigable rivers and that therefore, pursuant to the Equal Footing Doctrine, the state owns the beds of the rivers. The Equal Footing Doctrine provides that states admitted to the Union after the original 13 colonies obtained title to the beds beneath navigable water upon statehood. See Montana Coalition for Stream Access v. Curran, 210 Mont. 38, 682 P.2d 163 (1984), which contains a discussion of the Equal Footing Doctrine and the test for determining navigability. On August 28, 2007, the District Court issued a second memorandum and order concluding that the beds of the navigable rivers are public school trust land that comprise a portion of the public school fund because they fall within the category of land granted by the United States to the state of Montana without a special purpose designated for the land pursuant to Article X, section 2(4), of the Montana Constitution. On August 28, 2007, the District Court issued a third memorandum and order denying the plaintiff's motion for summary judgment. The District Court memorandum provided that the state's counterclaims were based entirely upon its allegations that the plaintiffs had occupied and continued to occupy state land without paying rental compensation. The District Court stated that pursuant to Article X, section 11, of the Montana Constitution, the state is the trustee of state land and the land may only be disposed of as provided by law. Therefore, the statute of limitations on the state's counterclaims could not have run because the disposition and use of state land protected by the Montana Constitution was directly at issue in the case.

On June 13, 2008, the District Court issued findings of fact and conclusions of law. In finding of fact 15, the District Court stated that the state has been aware of the presence of the projects since the dams were constructed. In findings of fact 17 and 18, the District Court noted that the Montana Power Company and PPL Montana had never applied for a lease under Title 77, chapter 4, part 2, MCA, and did not otherwise compensate the state for the full market value of the use of the riverbeds. Finding of fact 19 stated that the Department of Natural Resources and Conservation (DNRC) manages state trust land and that until Cause No. CDV-2004-846 was initiated, neither DNRC nor the Board of Land Commissioners had tried to determine the full

market value of riverbeds used to generate hydroelectric power. In findings of fact 41, 42, 43, and 49, the District Court refers to the "rent" due the state for the projects under the methodology it adopted. In finding of fact 50, the District Court noted that PPL Montana had hired an expert to determine what a "fair and reasonable per acre annual lease payment" would be if the state is entitled to compensation for the use and occupation of the riverbeds.

Among the conclusions of law that are relevant to your inquiry, the District Court held that:

(1) the riverbeds at issue are state school trust land and the state has a constitutional duty to obtain full market value for the use of school trust land;

(2) under section 77-4-208, MCA, the rental for state land used for a power site may not be less than the full market value of the estate or interest disposed of, as carefully ascertained from all available sources;

(3) the Federal Power Act does not preclude the state from seeking compensation for state trust land used in conjunction with the federally licensed power sites;

(4) the shared net benefits methodology relied on by the state is the most appropriate means of determining the full market value of the riverbeds;

(5) the state is entitled to compensation of the acreage of the riverbeds both below and above the dams in question that is within the project boundaries;

(6) the state was not entitled to prejudgment interest;

(7) the state was entitled to compensation in the amount of $34,748,261 for the years 2000 through 2006 and in the amount of $6,207,919 for 2007; and

(8) the terms of any lease must be approved by the Board of Land Commissioners, including provisions for calculating future rent.

On December 15, 2008, the Board of Land Commissioners adopted a resolution for the disposition of the proceeds of the award of "compensatory damages" in PPL Montana, LLC v. State of Montana. he resolution states that the award of "compensatory damages" for PPL's occupation of the riverbeds represents neither a permanent disposition of trust land nor is it payment under a state lease. The resolution states that consistent with Montanans for the Responsible Use of School Trust v. Darkenwald, 2005 Mont. 190, 328 Mont. 105, 119 P.3d 27 (2005), the Board must obtain full market value for future rent and must manage the school trust for the benefit of current and future beneficiaries. The Board determined that it is in the best interest of current and future beneficiaries of the common schools trust and is consistent with section 77-1-125, MCA, to secure the compensatory damages in a manner that will compensate the trust for past damages and continue to generate revenue both now and into the future. Based upon this conclusion, the Board of Land Commissioners directed the deposit of the entire amount of compensatory damages, including all postjudgment interest, into the state land bank fund established in section 77-2-362, MCA, so that the res of the trust will be enhanced and preserved. The resolution also states that the Board of Land Commissioners expressly reserves its authority to determine the full market value, based upon the shared net benefit methodology for future leasing of land under Title 77, chapter 4, part 2, MCA, including all terms and conditions of the future leases of the riverbeds.

Section 77-1-125, MCA, referred to in the resolution of the Board of Land Commissioners, provides that a person other than the lessee of the affected state trust land may not, after September 30, 1997, install or construct a facility or other structure on state trust land without obtaining an easement, lease, license, or other written permission of DNRC. A person violating the prohibition is liable to DNRC for a civil penalty in an amount determined by the Board of Land Commissioners. The penalty may be for three times the amount of the full market value of the land affected. The person may also be required to remove the facility or structure and to reclaim the disturbed land. Section 77-1-117, MCA, provides that all money received as penalties for the violation of the land laws of Montana, except money received by a justice's court, must be paid to the Department of Revenue for deposit in the general fund. Therefore the deposit of the "compensatory damages" in the state land bank fund is not consistent with section 77-1-125, MCA.

The resolution of the Board of Land Commissioners is interesting in light of the fact that the failure of the Board of Land Commissioners, the former Department of State Lands, and the Department of Natural Resources and Conservation to fulfill their constitutional duties and statutory obligations under Title 77, chapter 4, part 2, MCA, constitutes the basis for the state's counterclaim seeking monetary damages in the suit. In the Findings of Fact and Conclusions of Law issued by the District Court on June 13, 2008, the District Court concluded by stating that although a lease of the riverbeds is required, any lease must be approved by the Board of Land Commissioners and the Court cannot set the terms of the lease, including provisions for calculating future rents. This is an appropriate recognition of the Separation of Powers embodied in Article III, section 1, of the Montana Constitution.

The resolution of the Board of Land Commissioners raises legal issues if the determinations contained in the resolution are implemented. The language of the resolution refers to "compensatory damages". Section 27-1-202, MCA, provides that "Every person who suffers detriment from the unlawful act or omission of another may recover from the person in fault a compensation therefor in money, which is called damages." Black's Law Dictionary, 6th ed. (1990), states, "Compensatory damages are such as will compensate the injured party for the injury sustained, and nothing more; such as will simply make good or replace the loss caused by the wrong or injury. Damages awarded to a person as compensation, indemnity, or restitution for harm sustained by him. The rationale behind compensatory damages is to restore the injured party to the position he or she was in prior to the injury." As pointed out earlier, in the Findings of Fact, the District Court repeatedly referred to "rent" and "annual lease payment" and in the Conclusions of Law the District Court referred to "compensation" for specific time periods.

The land banking program was enacted in 2003. Section 77-2-361(2), MCA, defines "land banking" as a process of selling various parcels of state land and using the proceeds from the sales to purchase other land, easements, or improvements that are likely to provide greater or equal trust revenue, as may be reasonably expected over a 20-year accounting period with an acceptable level of risk, for the affected trust and to diversify the land holdings of the various trusts. In essence, "land banking" is a form of a deferred land exchange. Section 77-2-362, MCA

creates the state land bank fund. The proceeds from the sale of state trust land authorized by sections 77-2-361 through 77-2-367, MCA, must be deposited into the state land bank fund. The purpose of the state land bank fund is to temporarily hold proceeds from the sale of trust land pending the purchase of other land, easements, or improvements for the benefit of the beneficiaries of the respective trusts. There is nothing in statute that provides that the state land bank fund may be used to hold "compensatory damages" for the purpose of purchasing land or that allows for the deposit of any money other than the proceeds from the sale of state trust land in the state land bank fund. In addition, section 77-2-362, MCA, provides that the proceeds from the sale of state trust land that are deposited in the state land bank fund, except earnings on those proceeds, are statutorily appropriated to DNRC for the purposes described in sections 77-2-361 through 77-2-367, MCA. All of the earnings on the proceeds deposited in the state land bank fund are subject to the provisions of Article X, sections 5 and 10, of the Montana Constitution concerning public school fund revenue and state university funds. The deposit of the compensatory damages in the state land bank fund would not allow DNRC to use the compensatory damages to purchase land without a legislative appropriation because the compensatory damages are not "proceeds received from the sale of trust land" that are statutorily appropriated.

Article X, section 2, of the Montana Constitution creates the public school fund and subsection (4) of that section includes all grants of land made from the United States without special purpose. The District Court concluded that this provision constitutes the reason why the riverbeds of navigable rivers are part of the public school fund. Article X, section 3, of the Montana Constitution provides that the public school fund shall forever remain inviolate, guaranteed by the state against loss or diversion. Article X, section 5, of the Montana Constitution provides:

> (1) *Ninety-five percent of* all the interest received on the public school fund and ninety-five percent of all rent received from the leasing of school lands and *all other income from the public school fund shall be equitably apportioned annually to public elementary and secondary school districts as provided by law.*
>
> (2) *The remaining five percent of all* interest received on the public school fund, and the remaining five percent of all rent received from the leasing of school lands and all *other income from the public school fund shall annually be added to the public school fund and become and forever remain an inseparable and inviolable part thereof.* (emphasis added)

Section 20-9-341, MCA, defines "interest and income money" for school funding purposes as the total of the following revenue, as provided for by Article X, section 5, of the 1972 Montana constitution:

> (a) 95% of the interest received from the investment of the public school fund;
>
> (b) 95% of the interest received from the investment of any other school

funds held in trust by the state board of land commissioners;

(c) 95% of the income received from the leasing of or sale of timber from state school lands after any deductions that may be made under the provisions of Title 77, chapter 1, part 6; and

(d) *95% of any other income derived from any other covenant affecting the use of state school lands.*

(2) The remaining 5% of the revenue described in subsections (1)(a) through (1)(d) must be annually credited to the public school fund after any deductions made under 77-1-109. (emphasis added)

Section 20-9-342, MCA, provides that the Board of Land Commissioners shall annually deposit the interest and income money for each calendar year into the guarantee account, provided for in section 20-9-622, MCA, for state equalization aid by the last business day of February following the calendar year in which the money was received. Section 20-9-343, MCA, defines state equalization aid as revenue for distribution to the public schools for guaranteed tax base aid, BASE aid, state reimbursement for school facilities, grants for school technology purchases, and negotiated payments for an eligible child receiving inpatient treatment in an in-state residential treatment facility or children's psychiatric hospital. This definition and use of "interest and income money" complies with the requirement contained in Article X, section 5, of the Montana Constitution, that 95% of all of the interest received on the public school fund, 95% of all rent received from the leasing of school lands, and 95% of all other income from the public school fund be equitably apportioned annually to public elementary and secondary school districts as provided by law.

The statutes governing power sites on state land were enacted in 1931. Section 77-4-201, MCA, provides that it is unlawful to sell or advertise for sale state lands constituting power sites or a part of power sites capable of developing hydroelectric energy in commercial quantities. However, the Board of Land Commissioners may issue a lease or license to any person, corporation, or municipality for the development of power sites and for the distribution, use, and disposition of the electrical energy generated on the sites as specifically provided in Title 77, chapter 4. Section 77-4-202, MCA, provides that a "power site" means not only the state-owned land on which the dam is constructed, but also each separate tract of state-owned land that will become part of the reservoir and that in and of itself makes an essential contribution to the value of the power site as a whole of not less than 5% of the entire value of the power site. Section 77-4-208, MCA, provides that the rental to the state from a power site must be paid annually or semiannually and the rental may not be less than the full market value of the estate or interest disposed of through the granting of the lease or license. The full market value must be carefully ascertained from all available sources.

As justification for its decision to place the "foregone lease payments" or "compensatory damages" in the state land bank fund, the Board of Land Commissioners cites Darkenwald. The Darkenwald case involved a challenge to Senate Bill No. 495 from 2001, which authorized DNRC to borrow up to $75 million from the coal trust severance tax permanent fund for 30 years

to buy mineral production royalties owned by the public school fund in order to enhance short-term distributable revenue from the public school fund for the benefit of public schools. The plaintiff asserted that this statutory scheme violated the state's school trust duties by using an arbitrary method of determining the appropriate discount rate and by not requiring an independent appraisal to determine full market value of the future royalty stream. The District Court concluded that the state's method of determining the appropriate discount rate was neither arbitrary nor a breach of the duty to obtain fair market value, and on appeal, the Supreme Court affirmed that the discount rate was reasonable and reflected the full market value of the future stream of mineral royalties. Additionally, an independent appraisal was not necessary because when the state sells only an estate or interest in land, the state has ample power to determine the method by which to ascertain the full market value of the estate or interest. The Board of Land Commissioners bears the task of ensuring that the trust receives full market value for state land interests, and the Supreme Court declined to substitute its opinion for that of the Board unless the Board's action is arbitrary. The plaintiff failed to show that the financing scheme in Senate Bill No. 495 was unconstitutional beyond a reasonable doubt, and the Supreme Court affirmed that the state, by balancing the interests of present and future beneficiaries of the school trust through Senate Bill No. 495, fully complied with the Montana Constitution, The Enabling Act, and state statutes and thus did not violate its trust duties.

As described, Darkenwald addressed a statutory mechanism in which the only functions of the Board of Land Commissioners were to determine whether to sell the mineral production royalties and to determine the fair market value of the mineral production royalties. The balancing of the interests of the present and future beneficiaries was done in the authorizing legislation, Senate Bill No. 495 from 2001, which was enacted as Chapter 418, Laws of 2001. Therefore, it would be appropriate for the Legislature to balance the interests of present and future beneficiaries with regard to the potential funds available under PPL Montana, LLC v. State of Montana.

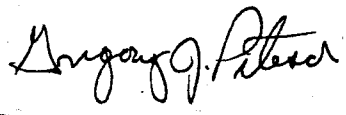
In PPL Montana, LLC v. State of Montana, the District Court specifically found that until the litigation was initiated, neither DNRC nor the Board of Land Commissioners had tried to determine the full market value of riverbeds used to generate hydroelectric power. By depositing the proceeds of the "foregone lease payments" or "compensatory damages" in the state land bank fund, only 95% of the interest and earnings on the proceeds will be distributed to the public schools and 5% of the interest and earnings on the proceeds will be deposited in the public school fund as provided in Article X, section 5, of the Montana Constitution. If the Board of Land Commissioners and DNRC had complied with their constitutional and statutory obligations to lease the "power sites" at issue in PPL Montana, LLC v. State of Montana, then pursuant to Article X, section 5, of the Montana Constitution, 95% of the lease payments would have been distributed to the public schools as state equalization aid and 5% of the lease payments would have been deposited in the Public School Fund established in Article X, section 2, of the Montana Constitution. None of the lease payments would have been placed in the state land bank fund. It is difficult to fathom how the violation of constitutional and statutory obligations on the part of the trustees can justify the deposit of the "compensatory damages" in a fund in which the "lease payments" could not be deposited if the constitutional and statutory obligations

been complied with.

Under the situation giving rise to PPL Montana, LLC v. State of Montana, and under the Board of Land Commissioner's subsequent resolution for the disposition of the proceeds of the award of compensatory damages, the Board of Land Commissioners and DNRC could fail to execute leases for state land held in the Public School Fund, sue the holdover lessee for compensatory damages at a later time, and deny the current beneficiary -- the existing public elementary and secondary schools -- of the vast majority of the revenue constitutionally dedicated to their support. This type of action would primarily benefit future beneficiaries to the detriment of current beneficiaries. This type of action would also violate the constitutional and statutory duties of the Board of Land Commissioners and DNRC and would provide the beneficiaries of the trust with a cause of action against the trustees. Pursuant to the rationale of Darkenwald, the Legislature may play a significant role in balancing the interests of present and future beneficiaries.

I hope that I have adequately addressed your request. If I can provide additional information or if you have additional questions, please feel free to contact me.

Sincerely,



Gregory J. Petesch
Director of Legal Services

Cl0425 9030gpxb.