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Memorandum

To: Environmental Quality Council Study Subcommittee

From: Krista Lee Evans, Research Analyst

RE: DNRC "revised funding formula" proposal in bill draft format

Date: February 24, 2006

At the January Subcommittee meeting you requested that I work with DNRC to develop their proposal regarding a new funding formula for administration and put that into a bill draft format so that it would be easier for you to understand what they were proposing.

Attached is a copy of this "account combo" bill (LC 7777) for your review. I have worked with DNRC to make sure that it reflects what they are proposing. I have identified a few issues that you might want to think about while you are considering this bill draft. These issues are identified below.

(1) Greg Petesch, Chief Legal Counsel, Legislative Services Division has stated numerous times that he believes that it is unconstitutional to use revenues from the public school trust to pay for administration. There are multiple trusts with multiple granting instruments that along with the Montana Constitution control whether or not it is appropriate to use revenues to fund administration. This bill draft does not address this issue and does not negate his concerns.

(2) Section 17-3-1003 states that "there is annually and perpetually appropriated . . . the income from all permanent endowments. . ." It appears that the intent is to make this a statutory appropriation. However, current practice requires that for this to truly be a statutory appropriation it must state "as provided in 17-7-502" and the statute (17-3-1003) must be listed in 17-7-502. This is more of a code cleanup and clarification suggestion.

(3) It is not clearly delineated in this bill draft, or in current statute for that matter, where the revenue received from the trusts (property) goes first. For example, assume there is a grazing lease that DNRC receives \$500 in lease payment. This grazing lease is on a parcel that is capitol building grant land. Does the \$500 go into the distributable

account for the capitol building grant and then 15% is paid back for expenses or does the \$500 go into the Trust Land Administration Account (TAC) 1st, 15% is deducted, and then the remainder goes into the distributable account for the capitol building grant?

DNRC plans to deposit revenues as they are received into the appropriate trust's investment account. Then, from that account 15%, or whatever percentage the legislature appropriated, would be sent back to the TAC account to pay for administration. Then, the funds would be distributed from the investment account into either the permanent fund or the distributable account for that particular trust depending on which activity generated the revenue.

The question is whether or not this process needs to be provided for in statute or is it better left to the department's discretion? One option would be to set up the various trusts similar to how the Treasure State Endowment program and others are set up within the coal trust with their permanent fund, then an income fund, and then an account that they can spend money from.

(4) Are the costs determined per trust? A new section -- subsection (5) in 77-1-108 speaks to how the costs will be apportioned -- to my knowledge this is the only place in statute (if this bill was passed) that addresses how the costs are allocated per trust. In a best case scenario costs would be tracked per trust and only the costs associated with activities conducted on or on behalf of that trust would be assessed against that trust's revenues - up to the maximum of 15% envisioned in this bill. This would conform to general trust principles and could help address the issues similar to the Morrill Act problem where the other trusts were bearing the cost of administration. The feasibility of tracking costs and to what detail would need to be discussed further. It is also important to recognize that the 15% figure works in the proposed bill - it might not work in this scenario so we would need to look at the numbers per trust to determine appropriate percentages.

(5) One alternative that staff has identified is to change from an "activity view" (timber harvest, recreational use, commercial lease, etc) to a "trust view". Ensure the department is keeping track of everything - both costs and revenues - on a per trust basis. This would potentially help make sure that revenues are exceeding costs on a per trust basis and it will also provide a more transparent process for the beneficiaries of each trust, the legislature, and citizens in general. One way of accomplish this (which is very similar to how DNRC manages the money right now - it would simply put it into statute) would be to:

- (a) establish an "income account" for each trust if one doesn't already exist; and
- (b) establish an "expense account" for each trust if one doesn't already exist.

Once these accounts are established make it clear that proceeds are initially deposited in the revenue account and expenses accrue in the expense account. DNRC "bills" the revenue account for the expenses that are in that trust's expense account. These expenses would be actual, not to exceed a maximum amount or 15% in the scenario in

the bill draft. Once again, these numbers would need to be looked at in more detail to make sure that on a direct expense to revenue calculation per trust the percentage is accurate. Once the administrative costs were deducted the funds could be deposited in the appropriate account or fund - either distributable for the trust or permanent fund for the trust based on how the funds were obtained.

(6) In this bill the "cap" is set at 15%. I would suggest that it would be a good idea to also include a "floor" in statute, 12% for example, to ensure that DNRC's fiduciary responsibilities to the trusts are not negatively affected by the lack of funding or inadequate funding.

(7) In the bill draft the term revenue has been defined in 77-1-108(1). This is important because the bill is saying that 15% of the gross revenue can be used for administration. You will see that in subsection (1)(c) it discusses "the proceeds from the sale or other disposition of interests in property". If it is a permanent disposition of property - as outlined in subsection (1)(c) - then the proceeds are required to go into the permanent fund for that trust. And for some trusts these permanent funds are inviolate and guaranteed against loss or diversion in the Montana Constitution. This subsection appears to be allowing the use of funds that should be deposited in the permanent fund for administrative purposes. I believe it is statutorily allowing a diversion, to pay for administrative costs, of permanent fund money. If the subcommittee decides to address this issue we would need to look at the numbers again to make sure they still work - the 15% was calculated using revenues from permanent disposition. If the permanent disposition revenues were not used the percentage would probably have to go up - maybe around 20%. In other words, 20% of distributable revenue would go to DNRC for administrative costs.

(8) There are multiple sections of law being repealed. I have included copies of all of those sections for your review. It appears that some of the sections that are being repealed are the sections of law that limited how the administrative funds can be used. I believe this is a policy choice regarding how many or what types of limits the legislature wants to place on the use of these funds.

If you have questions or comments please do not hesitate to contact me. My phone number is 444-1640 and my email is kevans@mt.gov.

Repealed Statutes

77-1-602. Definition of terms. Unless the context requires otherwise, in this part the following definitions apply:

(1) "Account" means the resource development account in the state special revenue fund.

(2) "Income" means all proceeds received for the use of state land except

revenue required by law to be placed in the permanent fund type and revenue from the sale of timber.

History: En. Sec. 2, Ch. 295, L. 1967; amd. Sec. 106, Ch. 428, L. 1973; R.C.M. 1947, 81-2402; amd. Sec. 36, Ch. 281, L. 1983; amd. Sec. 5, Ch. 14, Sp. L. January 1992; amd. Sec. 31, Ch. 34, L. 2001.

77-1-604. Resource development account. A resource development account in the state special revenue fund in the state treasury is created to be used solely for the purpose of investing in the improvement and development of state lands acquired by grant or foreclosure in order to increase the revenue to be derived therefrom for common school support and support of the other entities, institutions, and objects for which the lands are held in trust. Appropriations from the account shall be expended for no other purposes.

History: En. Sec. 3, Ch. 295, L. 1967; amd. Sec. 107, Ch. 428, L. 1973; R.C.M. 1947, 81-2403(part); amd. Sec. 1, Ch. 277, L. 1983.

77-1-606. Restriction on use of income from school and institutional lands.

Money in the resource development account created in 77-1-604 that is derived from the income from public school lands, university lands, agricultural college lands, scientific school lands, normal school lands, capitol building lands, or institutional lands must be expended by the department solely for the purpose of defraying the costs and expenses necessarily incurred in developing public lands of the same trust. If the board determines that public lands in a trust may be developed and moneys in the account from that trust are insufficient to defray the necessary costs and expenses incurred, the board may transfer sufficient moneys from other trusts in the account. Trust accounts from which money is transferred must be reimbursed by a method approved by the board.

History: En. Sec. 4, Ch. 295, L. 1967; amd. Sec. 1, Ch. 180, L. 1973; amd. Sec. 108, Ch. 428, L. 1973; R.C.M. 1947, 81-2404; amd. Sec. 2, Ch. 533, L. 1993.

77-1-607. Deductions from income for development account -- maximum percentage. (1) The board shall determine the amount or percentage of income, not to exceed 3%, that is necessary to achieve the purposes of this part and shall provide by rule for deductions of that amount or percentage from the income that is secured from the lands by the department for the trusts benefited by this part.

(2) The maximum percentage limitation in subsection (1) does not apply to income deducted and expended under the provisions of 77-1-613.

History: En. Sec. 5, Ch. 295, L. 1967; amd. Sec. 109, Ch. 428, L. 1973; R.C.M. 1947, 81-2405; amd. Sec. 3, Ch. 533, L. 1993; amd. Sec. 1, Ch. 247, L. 1997.

77-1-608. Crediting of deductions. All deductions from gross proceeds made in accordance with 77-1-607(1) must be paid into the account, and the balance of the proceeds must be paid into the state treasury to the credit of the proper account.

History: En. Sec. 6, Ch. 295, L. 1967; amd. Sec. 110, Ch. 428, L. 1973; R.C.M.

1947, 81-2406; amd. Sec. 4, Ch. 533, L. 1993.

77-1-609. Investment of moneys in development account. The board of investments shall invest the moneys in the resource development account in safe interest-bearing securities for the benefit of the account.

History: En. Sec. 7, Ch. 295, L. 1967; amd. Sec. 111, Ch. 428, L. 1973; R.C.M. 1947, 81-2407.

77-1-613. Deduction of portion of income received from sale of timber from state trust lands -- creation of account. (1) There is an account in the state special revenue fund called the state timber sale account. Money in the account may be appropriated by the legislature for use by the department in the manner set out in this section to enhance the revenue creditable to the trusts. There must be placed in the account an amount from timber sales on state lands each fiscal year equal to the amount appropriated from the account for the corresponding fiscal year.

(2) Timber sale program funds deducted under subsection (1) must be directly applied to timber sale preparation and documentation.

(3) In order to increase the volume of timber sold at the earliest possible time while continuing to meet the requirements of applicable state and federal laws and in order to avoid unnecessary delays and extra costs that would result from increasing its permanent staff, the department may contract for services that will enable achievement of the purposes of this section and that will achieve the highest net return to the trusts.

(4) To maximize overall return to the trusts, the timely salvage of timber must be considered. However, salvage timber sales may not adversely affect the implementation of green timber sales programs.

History: En. Sec. 1, Ch. 533, L. 1993; amd. Sec. 1, Ch. 157, L. 1995.

77-1-808. (Temporary) State lands recreational use account. (1) There is a state lands recreational use account in the state special revenue fund provided for in 17-2-102.

(2) There must be deposited in the account:

(a) all revenue received from the recreational use license established by 77-1-802;

(b) 10% of the revenue received as a result of an agreement with the department of fish, wildlife, and parks for the use and impacts of hunting, fishing, and trapping as provided in 77-1-815; and

(c) money received by the department in the form of legislative appropriations, reimbursements, gifts, federal funds, or appropriations from any source intended to be used for the purposes of this account.

(3) Money deposited in the state lands recreational use account must be used by the department for the following purposes:

(a) compensation pursuant to 77-1-809 for damage to the improvements of leases that has been proved to be caused by recreational users;

(b) assistance in weed control management necessary as a result of

recreational use of state lands;

(c) protection of the resource value of the trust assets;

(d) administration and management for the implementation of recreational use of state lands; and

(e) maintenance of roads necessary for public recreational use of state trust land. (Void on occurrence of contingency--sec. 8, Ch. 596, L. 2003.)

77-1-808. (Effective on occurrence of contingency) State lands recreational use account. (1) There is a state lands recreational use account in the state special revenue fund provided for in 17-2-102.

(2) There must be deposited in the account:

(a) all revenue received from the recreational use license established by 77-1-802; and

(b) money received by the department in the form of legislative appropriations, reimbursements, gifts, federal funds, or appropriations from any source intended to be used for the purposes of this account.

(3) Money deposited in the state lands recreational use account must be used by the department for the following purposes:

(a) compensation pursuant to 77-1-809 for damage to the improvements of leases that has been proved to be caused by recreational users;

(b) assistance in weed control management necessary as a result of recreational use of state lands;

(c) protection of the resource value of the trust assets; and

(d) administration and management for the implementation of recreational use of state lands.

History: En. Sec. 16, Ch. 609, L. 1991; amd. Sec. 68, Ch. 509, L. 1995; amd. Sec. 1, Ch. 117, L. 2001; amd. Sec. 6, Ch. 596, L. 2003.