



ADVOCATES FOR SCHOOL TRUST LANDS

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Attorney General Loretta Lynch
United States Department of Justice
950 Pennsylvania Avenue, NW
Washington, D.C. 20530-0001

Dear Attorney General Lynch:

A serious and substantial breach of trust against the Arizona Permanent School Fund and generations of Arizona school children is occurring. The recent and continuing distributions under Arizona Proposition 123 of Permanent School Fund monies is a dereliction of fiduciary duties. It also violates the terms of the New Mexico-Arizona Enabling Act (Enabling Act), legislation created by Congress to provide for support of public schools. Under the terms of the Act, defense of this trust lies in the office of the U. S. Attorney General.

The Attorney General of the United States is expressly charged with the duty "to prosecute, in the name of the United States and in its courts, such proceedings at law or in equity as may from time to time be necessary and appropriate to enforce the provisions hereof relative to the application and disposition of the said lands and the products thereof and the funds derived therefrom." Act, 28 Stat. 557, § 28 (1910).

As outlined in detail in the attached document, Arizona's actions constitute present and continuing violations of the Enabling Act and will continue to do so, necessitating prompt intervention by the U. S. Attorney General, as provided by §28 of the Enabling Act. These violations include:

- 1) Failure to obtain Congressional approval to change Enabling Act provisions relative to the school trust prior to implementation of Proposition 123;
- 2) Unlawful depletion of the Arizona Permanent School Fund; and
- 3) Use of a portion of Arizona Permanent School Fund for an impermissible purpose, namely to settle a lawsuit brought by school districts to recover an unrelated debt owed to the public schools by the State of Arizona.

While a pro se complaint relating to these violations, together with an application to proceed without prepaying fees or costs, was filed in the United States District Court on May 18, 2016 (CV-16-01538-PHX-JZB), documents in the court file do not evidence the intention or means to pursue this litigation in a timely fashion.

Since 2000, Advocates for School Trust Lands (Advocates), formerly Children's Land Alliance Supporting Schools, has worked to optimize revenues from 45 million acres of school trust lands, promoting prudent investment of over \$72 billion in permanent funds, for the support of public schools in the twenty states with active school trusts. Members include parents, educators, state and local school board members, state land commissioners, productive land users, together with national education and other non-profit organizations.

The undersigned Arizona residents join the Advocates in respectfully calling upon the U. S. Attorney General to protect schools, public school children, and the Arizona Permanent School Fund by investigating and taking corrective legal action. Should the breach continue without redress, in addition to Arizona, public school fund monies held and invested for the support of public schools in nineteen other states may also be at risk.

Respectfully,



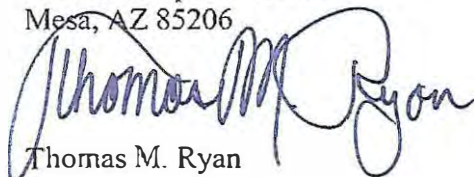
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VIOLATIONS OF ARIZONA SCHOOL TRUST

Introduction

In 1910, prior to Arizona becoming a state in 1912, the United States Congress passed the Arizona Enabling Act. The Act included provisions that confirmed prior land grants to the Arizona Territory and granted still more land to the new state. This land can be used only for specific purposes including the support of the common schools of the state. Currently, there are a total of 14 beneficiaries to the trust, with the public schools being the major beneficiary, receiving approximately 90% of the overall distribution. (Arizona Joint Legislative Budget Committee Fiscal Note for HCR 2056 (8/16/12)).

The Arizona Enabling Act expressly directs that the granted lands were to be held “in trust,” to be “disposed of in whole or in part only in the manner as herein provided...” *Act, 36 Stat. 557, § 28 (1910)*. It also provides that any disposition of trust lands or the monies and resources derived therefrom in a manner contrary to the provisions of the Enabling Act “shall be deemed a breach of trust.” *Id.*

The Attorney General of the United States is expressly charged with the duty “to prosecute, in the name of the United States and in its courts, such proceedings at law or in equity as may from time to time be necessary and appropriate to enforce the provisions hereof relative to the application and disposition of the said lands and the products thereof and the funds derived therefrom.” *Act, 28 Stat. 557, § 28 (1910)*. The United States Supreme Court has stated that the State of Arizona is specifically designated a trustee of school trust lands and funds, while the Federal Government expressly retains an ongoing oversight responsibility. *Papasan v. Allain, 478 U.S. 265 (1986)*.

Recent Actions

In May 2016, the State of Arizona passed Proposition 123, the Arizona Education Finance Amendment, a legislatively-referred constitutional amendment. The measure was designed to settle *Cave Creek Unified School District, et al. v. Jeff DeWit, et al.*, Maricopa County Superior Court Case No. CV2010, a lawsuit filed in 2010 challenging Arizona’s failure to increase education funding as required by Proposition 301.

Passed by Arizona voters in 2000, Proposition 301 increased statewide sales tax by .6% for 20 years to provide additional resources for education programs. (Office of the Auditor General Report to the Arizona Legislature (March 2002)). The measure included a requirement, codified at A.R.S §15-901.01, that the legislature make annual inflation adjustments to the budget for K–12 public schools. (Proposition 301 Analysis by Legislative Council, Arizona Secretary of State 2000 publicity pamphlet at page 172).

Beginning in 2010-2011, the Arizona Legislature stopped appropriating the mandated base level adjustments, following which several school districts and other parties sued the State Treasurer of Arizona. The Arizona Court of Appeals held that the legislature was required to provide the annual inflationary increase. *Cave Creek Unified School District, et al. v. Jeff DeWit, et al., 231*

Ariz. 342, 345 ¶ 1, 295 P.3d 440, 443 (App.2013), and the Arizona Supreme Court affirmed, *Cave Creek Unified School Dist. v. Ducev*, 233 Ariz. 1, 308 P. 3d 1152 (2013).

Despite this judicial ruling, base level adjustments were not forthcoming. Instead, after 5 years of legislative underfunding, the parties to the lawsuit entered into a settlement agreement conditioned upon voter approval of a new ballot measure, which was legislatively-referred in HB 2001 for voter approval as Proposition 123.

HB 2001/Proposition 123 increased the annual distribution from the Trust Land Permanent Funds in fiscal years 2016-2025 from 2.5% to 6.9%. (Arizona House of Representatives Committee Summary Sheet as Transmitted to the Secretary of State (HCR 2001) (October 30, 2015)).

Section 9 of HB 2001 states its purpose unambiguously:

The legislature finds that:

1. It is in the best interests of the State of Arizona to finally resolve the litigation in *Cave Creek Unified School District, et al. v. Jeff DeWitt, et al.*, Maricopa County Superior Court Case No. CV2010-017113, and all appellate proceedings related thereto.

...

3. Including the final judgment in the litigation, this act and the terms of House Concurrent Resolution 2001, fifty-second legislature, first special session, fully and finally resolve, satisfy and conclude all claims, causes of action, findings, rulings and judgments in the litigation.

This purpose is confirmed by Section 6 of related bill, SB 1001:

This act and the terms of Senate concurrent resolution 1001, fifty-second legislature, first special session, are intended to fully satisfy the requirements of section 15-901.01, Arizona Revised Statutes, and shall fully and finally resolve, satisfy and conclude all claims, causes of action, findings, rulings and judgments in *Cave Creek Unified School District, et al. v. Jeff DeWitt, et al.*, Maricopa County Superior Court Case No. CV2010-017113, and all appellate proceedings related thereto.

Proposition 123 dramatically reduces the future State Land Trust K-12 Permanent funds:

The value of the State Land Trust K-12 Permanent Fund balance is \$4.8 billion. Under the proposition, it is projected to be \$6.2 billion by 2025. In the absence of the proposition, the projected balance would be \$9.0 billion by 2025.

(Joint Legislative Budget Committee (JLBC) Fiscal Impact Summary for Ballot Proposition 123 (February 23, 2016))

Arizona State Treasurer Jeff DeWitt opposed Proposition 123 as did five former Arizona State

Treasurers: Dean Martin, Carol Springer, Ernest Garfield, Morris Herring and Bart Fleming. (KTAR News, April 28, 2016, updated April 29, 2016)

Voters narrowly approved Proposition 123 with 50.92% voting in favor at a statewide special election held on May 17, 2016. Following its passage, Arizona Treasurer and Chairman of the Board of Investment Jeff DeWit asked Attorney General Mark Brnovich to consider the legality of the approved measure. DeWit argued that the measure violated the original federal law that granted Arizona 10 million acres of federal land to support schools.

Solicitor General John Lopez said that the attorney general's office would not step in to block funding to schools. (Ariz. Att'y. Gen. Op. No. 116 – 007 (June 8, 2016), Mark Brnovich, Potential Liability of the State Board of Investment for Complying with Proposition 123)

The first distribution from the trust was made on June 28, 2016.

As outlined in detail below, the actions of the State violate the Arizona Enabling Act necessitating intervention by the US Attorney General, as provided by Section 28 of the Act. The violations include:

- 1) Failure to obtain United States Congressional approval to change Enabling Act provisions;
- 2) Unlawful depletion of the trust corpus; and
- 3) Use of Trust funds for an impermissible purpose, namely to settle a lawsuit brought by school districts to recover an unrelated debt owed to schools by the State of Arizona.

Violations of School Land Trust

1. United States Congressional consent is required to amend the Arizona-New Mexico Act because the Arizona State Constitution must conform to the provisions of the Act.

The 1910 Arizona-New Mexico Enabling Act authorizing the creation of the States of Arizona and New Mexico conditioned statehood on the voters of each state expressly accepting all provisions of the Act. Arizona voters incorporated their acceptance into Article XX, Sections 12 and 13 of the Arizona Constitution:

Twelfth. Lands granted to state

The state of Arizona and its people hereby consent to all and singular the provisions of the enabling act approved June 20, 1910, concerning the lands thereby granted or confirmed to the state, the terms and conditions upon which said grants and confirmations are made, and the means and manner of enforcing such terms and conditions, all in every respect and particular as in the aforesaid enabling act provided.

Thirteenth. Ordinance as part of constitution; amendment

This ordinance is hereby made a part of the Constitution of the state of Arizona, and **no future constitutional amendment shall be made which in any manner changes or abrogates this ordinance in whole or in part without the consent of Congress.** (emphasis added)

The Arizona Supreme Court has acknowledged this limitation on the authority of Arizona officials and voters. Neither “the legislature, nor the people may alter or amend the trust provisions contained in the Enabling Act without congressional approval.” *Kadish v. Arizona State Land Dept.* 155 Ariz 484, 747 P.2d 1183 (1987). The Enabling Act “cannot be altered, changed, amended, or disregarded without an act of Congress. *Murphy v. State* 65 Ariz. 338, 181 P.2d 336 (1947).

Arizona officials have also recognized the need to obtain Congressional approval in order to enact a constitutional change that deviates from the Enabling Act’s prescriptions. See *Deer Valley Unified School Dist. V. Superior Ct.*, 157 Ariz. 537, 539, 760 P.2d 537, 539 (Ariz. 1988).

Yet despite identical provisions in the Arizona Enabling Act and the Arizona State Constitution, as well as unambiguous case law precedent, Arizona has neglected to seek or obtain Congressional approval for two recent trust distribution revisions within the last five years. Neither the revisions to the calculation of distributions from the Trust pursuant to Proposition 118 (HCR 2056), which was approved by the voters in 2012, nor those contained in Proposition 123 (HCR 2001), which was approved by the voters in 2016, received the necessary Congressional approval prior to being implemented. Congress has not consented to these two most recent Arizona Constitutional changes, precluding the enactment of those provisions, and rendering those provisions null and void.

The implementation of provisions of Proposition 118 and Proposition 123 without the United States Congress approving the requisite changes to the Arizona Enabling Act is not supported by law or precedent. Independent action by the United States Congress to modify the Act is required to expand the authority of officials administering the Trust before said officials may legally act.

2. Distributions under Proposition 123 deplete the trust, undermining its purpose to provide for public education in perpetuity.

A trust is a fiduciary relationship with respect to property whereby the person holding title to the property is subject to equitable duties to keep or use the property for the benefit of another. This fiduciary relationship places on the trustee the duty to act with strict honesty and candor and solely in the interest of the beneficiary.

All trusts are not necessarily perpetual; perpetuity became a component of the school trust when the "permanent school funds" were first established. The funds became known as permanent school funds, and states enacted increasingly elaborate provisions for supplementing the fund

and for protecting it against loss and diversion. (Jon A. Souder & Sally K. Fairfax, *State Trust Lands: History, Management, and Sustainable Use*, University Press of Kansas (1996))

Arizona mismanaged the trust as early as 1915. The Courts reined in the mismanagement. See *Murphy v. State*, 65 Ariz. 338, 181 P 2d 336 (1947), *Rumery v. Baier*, 231 Ariz 275, 294 P.3d 113 (2013), *Kadish v. Arizona State Land Dept.*, 155 Ariz. 484, 747 P 2d 1183 (1987).

In 1966, the U.S. Supreme Court ruled that such actions violated the state's trust obligations. In *Lassen v. Arizona ex rel. Ariz. Hwy. Dep't.*, 385 U.S. 458, 17 L.Ed.2d 515, 87 S.Ct. 584 (1967). The court ruled that "**The Enabling Act unequivocally demands both that the trust receive the full value of any lands transferred from it and that any funds received be employed only for the purposes for which the lands was given.**" The Court concluded that the state must "**compensate the trust in money for the full appraised value of any material sites or rights of that which it obtains on or over trust lands.**" (emphasis added)

The legal term "corpus" represents the original value of trust assets, usually with an expectation that it will remain intact, though trust provisions often allow invasion for emergencies or other uses. Modern trust theory would generally hold that the corpus should be managed so as to preserve its original buying power, protecting it against inflation." (Artigue, C., Gammage, G., Hunting, D., & Stapp, M. *State Trust Lands and Education Funding*, Arizona State University, W. P. Carey School of Business (2015))

Arizona State Treasurer DeWit, who is responsible for management of the school land trust, states Proposition 123 will deplete the corpus of the trust. DeWit, J. (2015) *Treasurer Position on State Land Endowment Proposal*, available at: <http://www.aztreasury.gov/trust-fund-letter/> (Accessed: 18 August 2016).

Depletion of the trust corpus under Proposition 123 is evidenced by the FY 2016 data, the first fiscal year of the application of Proposition 123. The State Treasurer's Office reports that after depositing \$102 million from school land sales into the Permanent School Fund, after positive investment returns for FY 2016, and after distributing over \$259 million per Proposition 123, the Permanent School Fund at the end of FY 2016 is \$4,805,967,000, only one thousand dollars more than at the beginning of FY 2016, despite depositing over \$102 million from land sales. Clearly the corpus has been seriously diminished.

Depletion of the trust corpus for current schools diminishes the value for future schools and violates the intergenerational equity required of the school trusts.

3. The Permanent School Fund is being used to settle a debt owed by the State of Arizona and not owed by the trust

School trust funds may be used only for purposes authorized by the Arizona Enabling Act and may not be used for other state goals. *Lassen v. Arizona ex rel. Ariz. Hwy. Dep't.*, 385 U.S. 458, 17 L.Ed.2d 515, 87 S.Ct. 584 (1967) (Arizona could not transfer easements across trust lands without compensating the trust); *Ervien v. United States*, 251 U.S. 41, 64 L.Ed. 128, 40 S.Ct. 75

(1919) (Court rejected NM's use of trust asset funds to advertise and promote the State of New Mexico, against NM's argument that the ultimate effect would be to raise prices for the sale of other trust assets).

The Arizona Supreme Court has determined that "courts may not permit use of trust lands or their proceeds in ways not expressly authorized, even if doing so would benefit the trust." *Rumery v. Baier*, 231 Ariz. 275, 294 P.3d 113 (2013). See also *Murphy v. State*, 65 Ariz. 338, 353, 181 P.2d 336, 346 (1947) ("every act of the legislature that in any manner circumvents the plain provisions of the Enabling Act is struck down as unconstitutional and void"). Similarly, the Supreme Court of Washington held that "the State as trustee may not use trust assets to pursue other state goals." *Skamania v. Washington*, 102 Wn.2d 127, 685 P.2d 576(1984).

As noted above, related bills in both the Arizona Senate and House identify that the purpose of the trust distributions purportedly authorized by Arizona Proposition 123 is to resolve litigation in *Cave Creek Unified School District, et al. v. Jeff DeWit, et al.*, Maricopa County Superior Court Case No. CV2010-017113, and related appellate proceedings.

Not only is settling a lawsuit an unauthorized purpose, but the lawsuit itself arises out of a debt owed public school districts by the State of Arizona. The State of Arizona, as a trustee, is seeking to pay that debt, from the Permanent School Fund, using money that already belongs to Arizona schools. This contravenes the Arizona Enabling Act, the Arizona Constitution and the fiduciary duties of Arizona officials.

Conclusion

As a condition of statehood, Arizona agreed to the terms of the Arizona Enabling Act. The Act created a trust in perpetuity to fund public schools. The Arizona legislature has violated the terms of the trust by raiding the trust to pay a state debt. As stated by Arizona State Treasurer Jeff DeWit, Proposition 123 depletes the corpus of the trust, short changing Arizona's school children in perpetuity.

The explicit terms of the Arizona Enabling Act provide for action by the United States Attorney General when the State violates its terms. It is imperative that the Attorney General step in to stop these actions. Public education is the bedrock of our American democracy and is being threatened by the elected officials in Arizona.

We request an immediate referral to the United States Attorney General for all necessary actions to stop any further distributions of trust monies pursuant to Proposition 123 and to enforce compliance with the Arizona Enabling Act.