



OFFICE OF ATTORNEY GENERAL
STATE OF OKLAHOMA

ATTORNEY GENERAL OPINION
2019-4

The Honorable Rhonda Baker
Oklahoma House of Representatives, District 60
2300 N. Lincoln Blvd., Room 202A
Oklahoma City, OK 73105

February 14, 2019

The Honorable Dewayne Pemberton
Oklahoma State Senate, District 9
2300 N. Lincoln Blvd., Room 429
Oklahoma City, OK 73105

Dear Representative Baker and Senator Pemberton,

This office received your requests for an official Attorney General Opinion in which you ask, in effect, the following question:

May the Legislature by statute direct the Commissioners of the Land Office to expend the capital gains that accrue to the principal of the permanent school fund to benefit the common schools of the State consistent with the Oklahoma Enabling Act and Article XI of the Oklahoma Constitution?

I.
BACKGROUND

“The School Lands Trust, administered by the Commissioners of the Land Office, for the State as Trustee, consists of certain lands and funds granted to the State of Oklahoma upon its admission into the Union by the Enabling Act.” *Okla. Educ. Ass’n v. Nigh*, 1982 OK 22, ¶ 6, 642 P.2d 230, 235. Specifically, Section 7 of the Enabling Act set aside certain land from Oklahoma Territory and a sum of five million dollars for the “use and benefit of the common schools.” 34 Stat. 267, 272 (1906). The State must hold the money “in trust” for schools and “the interest thereon shall be used exclusively” for schools. *Id.* Section 9 orders any proceeds from the sale of land granted under Section 7 go to a “permanent school fund,” while “the interest of which *only* shall be expended in the support of such schools.” *Id.* at 274 (emphasis added).

Upon statehood, “[t]he gift of these lands and funds under the Enabling Act was accepted irrevocably by the people of Oklahoma, and such acceptance was set out in the Oklahoma Constitution under Article XI, Section 1.” *Nigh*, 1982 OK 22, ¶ 6, 642 P.2d at 235. In Article XI, Section 1, the State accepted “all grants of land and donations of money made by the United States

... for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated.” OKLA. CONST. art. XI, § 1. The State “pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.” *Id.* Section 2 of Article XI defines the principal of the permanent school fund, which includes proceeds from the sale of trust land, the original five million dollar grant, and other specified monies placed in the fund. *See also* 1996 OK AG 77, ¶ 10. “The principal shall be deemed a trust fund, and shall forever remain inviolate. It may be increased, but shall never be diminished.” OKLA. CONST. art XI, § 2; *see also* 2002 OK AG 36, ¶¶ 2-4; 1996 OK AG 77, ¶¶ 10-13.

The Constitution also requires the Legislature to “do all things necessary for the safety of the funds and permanency of the investment.” OKLA. CONST. art. XI, § 6(C). In the event that the fund experiences losses “which may in any manner occur,” the “State shall reimburse said permanent school fund for all losses thereof.” *Id.* § 2. Meanwhile, “the income from” this fund “shall be used for the maintenance of the common schools in the State.” *Id.* Section 3 of Article XI defines the revenue streams from the school land trust that are reserved for the common schools, which include “interest and income of the permanent school fund” and “the net income from the leasing of public lands” granted to the common schools land trust.

The Commissioners of the Land Office (“Commissioners”), acting as trustees, are responsible for the investment of the permanent school fund to provide “maximum benefits to current and future beneficiaries” under rules and regulations prescribed by the Legislature. OKLA. CONST. art. XI, § 6(B); *see also State ex rel. Comm’rs of the Land Office v. Lamascus*, 1953 OK 339, ¶ 0, 263 P.2d 426, 427. The Commissioners have no power to act other than under the rules set forth in the Enabling Act, the Oklahoma Constitution, and Oklahoma statutes. *Betts v. Comm’rs of the Land Office*, 1910 OK 51, ¶¶ 8-9, 110 P. 766, 769. But “[w]hile the Legislature . . . may regulate the activities of the Commissioners, it can neither abridge nor impair . . . their public obligation as managers of the trust estate.” *Nigh*, 1982 OK 22, ¶ 18, 642 P.2d at 238; *see also* 64 O.S.Supp.2018, § 1002 (setting forth the Commissioners’ powers and duties); 2004 OK AG 31, ¶ 11 (“[T]he Legislature may not enact laws which conflict with the terms and purpose of the grant in the Enabling Act establishing the school trust lands or modify, restrict or change its regulations.” (citing *State ex rel. Williamson v. Comm’rs of the Land Office*, 1956 OK 243, 301 P.2d 655, 659)).

The perpetual beneficiaries of the school land trust are the common schools of Oklahoma. The Constitution mandates that the “interest and income of the permanent school fund,” *inter alia*, be apportioned according to “school population” for the “support and maintenance of common schools.” OKLA. CONST. art. XI, § 3. Furthermore, any disposition of land or funds held in the school land trust that would conflict with the terms of the Enabling Act or the Oklahoma Constitution is invalid. *See* 1996 OK AG 1, ¶¶ 11-12 (quoting *Nigh*, 1982 OK 22, 642 P.2d at 235).

II. DISCUSSION

You ask whether capital gains that accrue to the principal of the permanent school fund may be expended in support of the common schools. The answer depends on whether capital gains constitute increases to the fund’s “principal” or instead are “interest and income” from the fund.

“The express designation of the school lands and funds as a ‘sacred trust’ has the effect of irrevocably incorporating into the Enabling Act, Oklahoma Constitution, and conditions of the grant, all of the rules of law and duties governing the administration of trusts.” *Nigh*, 1982 OK 22, ¶ 6, 642 P.2d at 235-36. A trust allows a trustee to hold and manage assets on behalf of a beneficiary. *See generally* WILLIAM M. MCGOVERN, JR. & SHELDON F. KURTZ, *WILLS, TRUSTS AND ESTATES* § 9.2, at 321 (2d ed. 2001); 60 O.S.2011, § 175.6 (setting forth parameters for creating a trust under the Oklahoma Trust Act). In general, trust property consists of principal and income. The principal is “any real or personal property” available to produce income, while income is “the return derived from principal.” 60 O.S.2011, § 175.3(G)-(H). Distributions to the beneficiary (here, the common schools) may be paid from income, but not the principal. *See* OKLA. CONST. art. XI, § 3.

The understanding since the time of statehood is that capital gains or “[p]rofits accruing from the sale or exchange of trust property” are treated as principal (not income) by default. GEORGE GLEASON BOGERT, *HANDBOOK OF THE LAW OF TRUSTS* (1921). “A rise in the value of trust investments, like a rise in the value of lands held in trust, has *always* been regarded as an accretion of the principal[.]” *In re Graham’s Estate*, 47 A. 1108 (Pa. 1901) (quoting *In re Hubley’s Estate*, 16 Phila. 327) (emphasis added). For example, “[w]hen trust funds are invested in the purchase of shares of stock in a railroad company the principal is not the cash paid for the stock but the stock itself and if that is later sold for more than the trustee paid for it the increase is not income but belongs to principal.” EDWIN HOWES, *THE AMERICAN LAW RELATING TO INCOME AND PRINCIPAL* (1905 Ed.); *see also* MCGOVERN & KURTZ, *supra*, § 9.4 at 332 (“When property is sold the proceeds are allocated to principal, including capital gains which are taxed as income under federal law.”). Thus, absent specification to the contrary in the Constitution and Enabling Act, capital gains are allocated to principal, and not part of the distributable income.¹

Based on this understanding, any distribution of capital gains from the permanent school fund to provide monies for the support or maintenance of the common schools would be an invasion of the fund’s principal and would be unlawful. As noted above, Article XI, Section 2 of the Oklahoma Constitution provides that only the “income” shall be used for the schools and the principal “shall forever remain inviolate” and “never be diminished,” while Section 9 of the Enabling Act similarly permits only interest to be expended. *See also Popp v. Munger*, 1928 OK 277, ¶ 11, 268 P. 1100, 1102; *Bd. of Comm’rs of Woods Cty. v. State ex rel. Comm’rs of the Land Office*, 1926 OK 302, ¶¶ 9-10, 257 P. 778, 780. Finally, to the extent that the permanent school fund’s principal, including any capital gains accruing thereto, were to be expended, the Constitution would require that the “State shall reimburse said permanent school fund for all losses.” OKLA. CONST. art. XI, § 2; *cf.* 1996 OK AG 77, ¶¶ 15-22.

Further, the consequences of a distribution of the fund’s principal may extend beyond its unconstitutionality. The Enabling Act is a federal law, “which may not be modified, restricted or changed by an Act of the Oklahoma Legislature or the people of Oklahoma in amendment of the

¹ *See also Tait v. Peck*, 194 N.E.2d 707 (Mass. 1963) (holding that capital gains distributions from mutual funds are principal); *Carpenter v. Perkins*, 74 A. 1062 (Conn. 1910) (holding that the increase in the value of a fund held in trust to pay the income to one for life is a part of the capital, and is not income); *Cartwright v. Jackson Capital Partners, Ltd. P’ship*, 478 S.W.3d 596, 626 (Tenn. Ct. App. 2015) (“[T]he default rule in the [Uniform Income and Principal Act] applies, and the trustee must allocate capital gains to principal.”).

Oklahoma Constitution.” *Williamson*, 1956 OK 243, ¶ 19, 301 P.2d at 659. The United States granted the land and funds to Oklahoma in trust, such that “the common school fund does not belong to the state, but the state merely holds such fund in trust under the conditions of the federal grant.” *Woods Cty.*, 1926 OK 302, ¶ 9, 257 P. at 779-80. Violations of the terms of the grant may “constitute grounds for termination of the trust and withdrawal of the funds by the federal government.” *Id.* ¶ 10, 257 P. at 780. Such a violation may risk permanently depriving the State of the benefit of the \$2.4 billion in principal currently held in in the school land trust, as well as the hundreds of millions of dollars of income and interest that is annually expended in support of the common schools of Oklahoma.

It is, therefore, the Official Opinion of the Attorney General that:

The Commissioners of the Land Office are not permitted, pursuant to statute or otherwise, to expend the capital gains that accrue to the principal of the permanent school fund. Capital gains are not income or interest generated by the fund’s principal, but rather constitute increases to the principal itself, which shall forever remain inviolate. OKLA. CONST. art. XI, §§ 2 & 3; Oklahoma Enabling Act, §§ 7 & 9, 34 Stat. 267, 272-74 (1906).



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