

STATE OF NORTH DAKOTA

ATTORNEY GENERAL'S OPINION 92-13

Date issued: August 19, 1992

Requested by: Honorable Ron Carlisle  
State Representative

- QUESTIONS PRESENTED -

I.

Whether it is a violation of N.D. Const. art. X, ' 21 for the Board of University and School Lands to invest coal severance tax trust fund moneys in shares of the Myron G. Nelson Fund, Incorporated.

II.

Whether it is a violation of N.D. Const. art. X, ' 18 for the Board of University and School Lands to invest coal severance tax trust fund moneys in shares of the Myron G. Nelson Fund, Incorporated.

- ATTORNEY GENERAL'S OPINION -

I.

Whether it is a violation of N.D. Const. art. X, ' 21 for the Board of University and School Lands to invest coal severance tax trust fund moneys in shares of the Myron G. Nelson Fund, Incorporated, is a question of fact which I am not authorized to answer.

II.

It is my opinion that it is not a violation of N.D. Const. art. X, ' 18 for the Board of University and School Lands to invest money from the coal severance tax trust fund in the Myron G. Nelson Fund, Incorporated.

- ANALYSES -

I.

The Myron G. Nelson Fund, Incorporated (Fund), a public corporation, was established in 1987. 1987 N.D. Sess. Laws ch. 141. Its purpose is to organize and manage an investment fund to provide a source of investment capital for the establishment, expansion, and rehabilitation of North Dakota businesses. N.D.C.C. ' 10-30.2-02. The Fund is financed through the sale of shares of the Fund to the Bank of North Dakota and other public and private investors. Id.

The state imposes a coal severance tax upon all coal severed for sale or for industrial purposes by coal mines within the state. N.D.C.C. ch. 57-61. At least 15% of the tax is to be placed into a permanent trust fund to be administered by the Board of University and School Lands (Land Board). N.D. Const. art. X, ' 21. The Land Board "shall have full authority to invest said trust funds as provided by law . . . ." Id.

The language in N.D. Const. art. X, ' 21, stating that the Land Board "shall have full authority to invest" authorizes the Land Board to invest the trust fund moneys. The language in N.D. Const. art. X, ' 21, "as provided by law," means the Board's investments must comply with legislative and constitutional guidelines. Other than N.D. Const. art. X, ' 18, discussed below, there are no constitutional guidelines. The only investment guideline established by the Legislature is in N.D.C.C. ' 15-03-04, which states that the Land Board must apply the prudent investor rule in investing the permanent funds under its control. The prudent investor rule "means that in making investments the board shall exercise the same judgment and care, under the circumstances then prevailing and limitations of North Dakota and federal law, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income." N.D.C.C. ' 15-03-04.

The Land Board's investment in the Fund is about 4.6% of the coal severance tax trust fund's unloaned balance. The prospectus of the Fund clearly states that the securities offered are speculative and involve a high degree of risk. Investors are advised that there is a chance the entire investment could be lost and that those not willing or able to suffer the complete loss of their invested capital should not consider investing.

The prudent investor rule establishes standards which must be met in investing assets of a trust. These standards have undergone substantial revision with the adoption by the American Law Institute of new trust instrument sections of Restatement (Third) Trusts. The general effect of these revisions, as explained in the Foreword to Restatement (Third) Trusts (Prudent Investor Rule), is as follows:

This formulation of the prudent investor rule affords more latitude for exercise of judgment by the trustee than had been thought permitted by the Restatement Second of Trusts. Moreover, the revised rule focuses on the trust's portfolio as a whole and the investment strategy on which it is based, rather than viewing a specific investment in isolation. Accordingly, it is not a proper ground for challenging a specific trust investment that it entailed substantial risk, if that investment was appropriate considering the trust's assets, purposes, and circumstances as a whole.

Restatement (Third) Trusts (Prudent Investor Rule) Foreword (1990).

The major revisions are found in " 227-229 of Restatement (Third) Trusts. These new sections "constitute a reformulation, in the context of modern portfolio theory and contemporary investment practices and techniques, of the traditional rules governing the trustee's duty to invest and manage the assets of the trust prudently." George G. Bogert and George T. Bogert, The Law of Trusts and Trustees ' 612 (2d ed. rev., 1980). The Introduction to Topic 5 (Investment of Trust Funds), Chapter 7, from Restatement (Third) Trusts (Prudent Investor Rule) provides in part as follows:

Principles of prudence. In addition to the fundamental proposition that no investments or techniques are imprudent per se, there are a few principles of prudence set out in the sections that follow. These principles instruct trustees and courts that:  
(1) sound diversification is fundamental to risk management and is therefore ordinarily required of trustees; (2) risk and return are so directly related that trustees have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of the trusts they administer. . . .

. . . .

Case law and prior Restatements have condemned "speculation" and excessive risk without definition, as if such risk could be recognized in the abstract without regard to portfolio context and objectives. The prudent investor rule recognizes that investments and courses of action are properly judged not in isolation but on the basis of the roles they are to play in specific trust portfolios and strategies.

Restatement (Third) Trusts (Prudent Investor Rule) Chapter 7, Topic 5, Introduction (1990).

Citing to the official Comments to ' 227 of Restatements (Third) Trusts, Bogert and Bogert state as follows:

The prudent investment standard requires the trustee to exercise reasonable care, skill and caution, caution in making investments with a view both to safety of principal and securing a reasonable return. [Citation omitted.] In the Introduction to Topic V it is stated that "the prudent investor rule recognizes that investments and courses of action are properly judged not in isolation but on the basis of the roles they are to play in specific trust portfolios and strategies." Since risk and return "are so directly related that trustees have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of the trusts being administered," the trustee "is to make a deliberate assessment and judgment about a suitable level of risk and reward in light of the ordinary trust's return requirements, risk tolerance, general purposes, specific terms and other

pertinent circumstances." [Citation omitted.]

Restatement, Third, does not endorse any particular theories of economics or investment in the making of trust investments. No investment is to be considered imprudent per se. Whether a breach of trust occurs by reason of an investment depends upon the prudence of the trustee's conduct and not upon the eventual results of the trustee's investment decisions. [Citation omitted.]

Bogert and Bogert, supra ' 671.

The conduct referred to immediately above is the conduct of the trustee concerning the care, skill, and caution exercised by the trustee throughout

the process through which investment strategies and tactics are developed, adopted, implemented, and monitored. Prudence is demonstrated by the process through which risk is managed rather than by the labeling of specific investment risks as either prudent or imprudent. Investment products and techniques are essentially neutral; none should be classified prudent or imprudent per se. It is the way in which they are used, and how decisions as to their use are made, that should be examined to determine whether the prudence standard has been met.

More specifically, for any investment product or technique employed by a fiduciary or any delegate selected by the fiduciary in connection with such employment (including pooled investment vehicles), the test of prudence is the care, diligence, and skill demonstrated by the fiduciary in considering all relevant factors bearing on an investment decision. If particular investment products or techniques are not imprudent per se, neither are they per se prudent for all purposes and at all times. Their use, without more, will not suffice. Prudence is not self-evident. Nor will it be enough to point to their use by other fiduciaries.

What matters is not that others have used the product or technique (for whatever reasons), but the basis for its use by the fiduciary in question.

Bogert and Bogert, supra ' 671 (quoting Longstreth, Modern Investment Management and the Prudent Man Rule (1986)).

Whether the Land Board's investment in shares of the Fund complies with the prudent investor rule is a question of fact which I am not authorized to answer, but which must be addressed in the first instance by the Land Board itself, taking into consideration its investment strategies and its portfolio of investments. Because it is a question of fact, the answer to this question may only be arrived at after a review of the entire process through which the Land Board has established its investment strategies and tactics and an analysis of whether it would be in furtherance of those strategies and tactics to purchase shares of the Fund at any given time, taking into consideration

the Land Board's investment portfolio at that time.

II.

The prudent investor rule allows investing within the limitations of state and federal law. One such limitation is set out in N.D. Const. art. X, ' 18, which states:

Section 18. The state, any county or city may make internal improvements and may engage in any industry, enterprise or business, not prohibited by article XX of the constitution, but neither the state nor any political subdivision thereof shall otherwise loan or give its credit or make donations to or in aid of any individual, association or corporation except for reasonable support of the poor, nor subscribe to or become the owner of capital stock in any association or corporation.

The reference to article XX is moot because article XX was repealed in 1932. 1933 N. D. Sess. Laws art. amd. 47, at 492.

In Gripentrog v. City of Wahpeton, 126 N.W.2d 230, 237-38 (N.D. 1964), the court considered the legality of a city's revenue bonds issued under the Municipal Industrial Developmental Act for the construction of a sugar beet processing plant which the city proposed to lease to a private company. The court ruled:

Section 185 [predecessor to section 18] does not prohibit the making of loans or giving of credit or making donations in connection with a city's engaging in any industry, enterprise, or business except engaging in liquor traffic. What it does prohibit is for a city "otherwise" to make loans or give its credit or make donations. In other words, making loans or giving credit may be done in connection with the city's engaging in any permissible industry, enterprise, or business, but not otherwise.

As we said in Northwestern Bell Telephone v. Wentz, 103 N.W.2d 245 (N.D. 1960), it is common knowledge that no one can successfully engage in an industry, enterprise, or business without in some manner being involved in lending, the giving of credit, or the making of donations. Surely, the framers of Section 185 of our Constitution would not have granted to the State and to any county or city the power to engage in industry, enterprise, or business and then have denied them the right to make loans or give credit in connection with the operation of such industry, enterprise, or business.

In 1991 I summarized the supreme court holdings on N.D. Const. art. X, ' 18 by stating:

Based upon the foregoing, it is my opinion that the state, county, or city may loan or give its credit or make donations only through

an industry, business, or enterprise in which it is engaged. Further, the industry, enterprise, or business engaged in by the state, city or county must have for its objective the promotion of the general welfare of all the inhabitants or residents within the state, city or county. In other words, the industry, enterprise, or business must be engaged in by the state, county, or city for a public purpose.

Letter from Attorney General Nicholas J. Spaeth to Rep. Clarence Martin (February 11, 1991).

In 1967 an Attorney General's opinion determined that investments in capital stock by the State Employee's Retirement Fund (Retirement Fund) did not violate N.D. Const. art. X, ' 18. The reasoning was that the state, through the Retirement Fund, was "engaged in the investing business for its employees which is a lawful business or enterprise." 1967 N.D. Op. Att'y Gen. 220, 221.

The investment activities of the Land Board concerning the coal severance tax trust fund under N.D. Const. art. X, ' 21, constitute a lawful enterprise engaged in for a public purpose. Therefore, it is my opinion that investments in shares of the Fund by the Land Board would not contravene N.D. Const. art. X, ' 18.

- EFFECT -

This opinion is issued pursuant to N.D.C.C. ' 54-12-01. It governs the actions of public officials until such time as the questions presented are decided by the courts.

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