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64th Montana Legislature

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TO: Education and Local Government (ELG) Committee Members
FROM: Laura Sankey, Staff Attorney
DATE: January 14, 2016
RE: Legal analysis of the application of the U.S. Supreme Court's decision in Lassen v. Arizona to historic rights-of-way in Montana and the requirement to obtain full market value for those rights-of-way

At the September 2015 meeting, ELG members raised a couple of questions regarding the U. S. Supreme Court's decision in Lassen v. Arizona, how that court case applies in Montana, and how the requirement to obtain full market value for school trust lands compares with the fee simple value of land when talking about an interest in land smaller than a fee simple interest. This memo is intended to provide brief answers to those questions.

Questions Presented:

1. How does the U.S. Supreme Court's decision in Lassen v. Arizona, 385 U.S. 458 (1967), apply to the discussion of historic rights-of-way in Montana?
2. Does Montana have to be compensated for the fee simple value of the land under a historic right-of-way to meet the requirement of obtaining full market value for that interest?

Short Answers:

1. Through the Montana Supreme Court's application of Lassen, the state cannot grant a historic right-of-way to a county without receiving the full market value of that historic right-of-way from the county in return.
2. Possibly not. The language in Montana's constitution and the state's Enabling Act both address "any estate or interest therein," and a right-of-way or easement is a smaller interest in land than a fee simple interest.

Question 1: How does the U.S. Supreme Court's decision in Lassen v. Arizona, 385 U.S. 458 (1967), apply to the discussion of historic rights-of-way in Montana?

The dispute in Lassen v. Arizona, 385 U.S. 458 (1967), involved two separate state agencies arguing about compensation for building a highway over the state's school trust lands. In 1966, Arizona's Land Commissioner adopted new rules requiring that any rights-of-way over state trust lands be compensated by full payment of the appraised value to the State Land Department. Lassen, 385 U.S. at 459-461. Arizona's Highway Department brought suit, alleging that it should not have to make a payment to the

Land Department for these rights-of-way, arguing that highways constructed across the trust lands enhanced the value of the remaining trust lands in an amount at least equal to the value of the right of way and therefore that enhanced value should offset any actual compensation otherwise owed to the trust. Id.

The Arizona Supreme Court held that this enhanced value was a conclusive presumption, and ordered the Commissioner to grant rights-of-way on trust lands to the Highway Department without collecting actual compensation from the Highway Department. Id. at 460. On appeal, the U.S. Supreme Court reversed the Arizona Supreme Court's decision. Id. at 470.

The U.S. Supreme Court looked carefully at the language of the New Mexico-Arizona Enabling Act ("Act"), which provided that Arizona be granted more than 10 million acres of land to be held in trust. Id. at 461-463. The Court determined that this grant of land was intended to create a trust that would be funded by the sale and use of the trust lands to support the common schools and other public institutions identified in that Act. Id. at 463 and n.2.

The Court rejected the Highway Department's argument that it should be able to avoid paying money for a right of way because the value to the remaining trust lands would be enhanced by an amount at least equal to the amount calculated under Arizona's condemnation statute for the land underneath the highway. Id. at 465. Instead, the Court looked at the Act's requirements, which included certain procedural constraints designed to obtain full and fair compensation for trust lands. Id. at 461-463. The Court concluded "the terms and purposes of the grant [of trust lands] do not permit Arizona to diminish the actual compensation, meaning thereby monetary compensation, payable to the trust by the amount of any enhancement in the value of the remaining trust lands." Id. at 466. The Court held that Arizona was required to make actual payment to the trust in an amount equal to the full appraised value of any right-of-way granted on or over trust lands. Id. at 469.

Over the next 30 years, a number of courts in other states relied on Lassen to reach similar conclusions about the requirement to obtain full market value for trust lands, even when those states had been granted their trust lands under different enabling acts.¹ Finally, the issue was presented to the Montana Supreme Court in a case that was discussed at ELG's September meeting, Montanans for the Responsible Use of the School Trust v. State, 1999 MT 263 ("Montrust").

The plaintiffs in Montrust brought suit in 1997 challenging the constitutionality of a number of state statutes, including the law that established specific fees for historic right-of-way deeds. Montrust, 1999 MT at ¶¶ 4, 12. The historic rights-of-way statute, 77-1-130, MCA, set values for the full market value for the historic rights-of-way based on four classifications of land, but those values were based on the median values for those land classifications in 1972. Id. at ¶ 21. On appeal, the Montana Supreme Court discussed the nature of the lands at issue, concluding first that the federal government's grant of lands under Montana's Enabling Act ("Enabling Act") constituted a trust and second that the terms of the trust are set out in the state constitution and the Enabling Act. Id. at ¶ 13.

¹ For additional background regarding states' adoption of the Lassen court's reasoning to apply to trust lands granted under other enabling acts, see Erin Pounds, *State Trust Lands: Static Management and Shifting Value Perspectives*, 41 Environmental Law 1333 (Fall 2011).

One of the terms of this trust, found in both the constitution and the Enabling Act, is that the full market value of the trust land must be obtained before the land can be disposed of. Id. at ¶ 14. Pursuant to Article X, Section 11(2), of the state constitution:

(2) No such land or any estate or interest therein shall ever be disposed of except in pursuance of general laws providing for such disposition, or until the full market value of the estate or interest disposed of, to be ascertained in such manner as may be provided by law, has been paid or safely secured to the state.

The Court also looked to the language in Lassen, relying on the U.S. Supreme Court's argument that the failure to make full payment of the appraised value of trust land deprives the trust of the full benefit of the land granted by the federal government. Montrust at ¶¶ 50-51. Because 77-1-130, MCA, required the full market valuation for historic rights-of-way to be tied to 1972 values, the Montana Supreme Court held that the statute "clearly violates the State's constitutional obligation to obtain full market value for school trust lands."

The same constitutional obligation to obtain full market value for school trust lands applies today in equal measure. Because the state holds these school trust lands in trust for the benefit of the people of the state of Montana, the state may not dispose of any land or estate or interest therein unless the full market value of that estate or interest has been paid to the state. Art. X, sec. 11(1), (2).

Question 2: Does Montana have to be compensated for the fee simple value of the land under a historic right-of-way to meet the requirement of obtaining full market value for that interest?

As discussed in the answer to Question 1, Montana's State Land Board is required to obtain the full market value of any estate or interest in school trust land that is sold or leased, in order to meet its obligations as the trustee of the school trust lands. Art. X, sec. 11(2). However, the language in the state constitution refers to "land or any estate or interest therein," which raises the question of what the full market value of an estate or interest in that trust land is.

Before we can compare the different types of interest in land, it is important to understand what exactly are the interests under discussion.² To start, a fee simple interest in land is the broadest property interest allowed by law. Some of the myriad rights defining fee simple property ownership include the right to sell, the right to keep, the right to lease, the right to exclude others from the property, and the right to allow others use of the property.

In contrast, an easement is an interest or right to use land that is owned by another person; a common form of an easement is a right-of-way, which is the right to pass through property owned by another. One feature of an easement is that while it may be granted for a specific purpose, it may also last forever;

² For this discussion about interests in land and full market valuation, I've relied on Todd Everts' memo, "Legal Analysis Regarding Full Market Valuation of State Land Cabin Sites", provided to the Environmental Quality Council and dated February 16, 2010, and Black's Law Dictionary (10th Ed. 2014).

other smaller property interests, such as leases or licenses, are generally granted for a definite or finite period of time. In addition, the statute regarding historic rights-of-way provides its own definition for historic rights-of-way and the accompanying deeds, which are "a document issued by the [Department of Natural Resources and Conservation] granting to the applicant a nonexclusive easement over state land." 77-1-130, MCA. Finally, full market value can be defined as the most probable price or rate of return that a property, property right, or property interest would bring in a competitive market. The Department of Natural Resources and Conservation has adopted the following definition of "full market value" in rule: "the most probable price in terms of money that a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and the seller each acting prudently, knowledgeably, and assuming the price is not affected by undue stimulus." ARM 36.25.102(11).

The question then is, does a right-of-way have the same full market value as the fee simple interest in the same underlying property? While I haven't found any cases that are directly on point with the question of how to measure the full market value of an easement, the following cases illustrate how courts are treating rights-of-way separately and distinctly from other interests in land.

Alamo Land & Cattle Co. v. Arizona, 424 U.S. 295 (1976) ("Alamo"), is a U.S. Supreme Court case that involved a condemnation action by the federal government over school trust lands that the state of Arizona had leased to the Alamo Land & Cattle Co. under a grazing lease. Alamo, 424 U.S. at 298. At issue in the condemnation proceeding was the question of who was entitled to receive compensation from the United States for the condemnation, Alamo Land & Cattle Co. or Arizona. After revisiting the Court's analysis in Lassen, the Court held that the trust is entitled to receive the full rental value for the leased property at the time the lease is executed, and that if the leased property is subsequently condemned, the trust is entitled to the value of the reversionary interest (i.e. the interest that the trust holds on to while the lessee holds the leasehold interest) plus the value of the remaining rent due under the lease. However, the compensable value for the leasehold interest belongs to the lessee, not the trust. Id. at 303-304.

Having established that Alamo Land & Cattle Co. was entitled to compensation for its interest in the grazing lease, the Court then examined the value of that interest. The Court cited an earlier case, which described the measure of damages to leasehold interest as "the value of the use and occupancy of the leasehold for the remainder of the tenant's term, plus the value of the right to renew... less the agreed rent which the tenant would pay for such use and occupancy." Id. at 304, citing United States v. Petty Motor Co., 327 U.S. 372, 381 (1946). The Court also discussed a variety of circumstances in which the value of a lease may have increased or decreased during the term of the lease. See Alamo at 304-305. The Court ultimately remanded the case back to the Ninth Circuit Court of Appeals to determine, assuming Alamo Land & Cattle Co. established its compensable interest, how to properly evaluate and calculate the damages caused by the condemnation action. Id. at 311.

In Wessells v. Alaska Dept. of Highways, 562 P.2d 1042 (Alaska, 1977), the plaintiff had been leasing over 12 acres of commercial and industrial land from Alaska's Division of Lands for many years. In the middle of the lease term, the Division of Lands granted the State Department of Highways a right-of-way over the entire property Wessells had leased. Wessells, 562 P.2d at 1044. The Division of Lands took this action pursuant to the lease agreement, which contained a clause that reserved to the state the right to grant an easement or a right-of-way over the leased property, and set the compensation to the leaseholder at the value of any improvements or crops that were damaged or destroyed as a direct result of that easement

or right-of-way. Id. While the Department of Highways paid \$585,700 for the right-of-way, the Department offered Wessells \$35,000 as the fair market value for the improvements to the leased land. Id. at 1045. Wessells declined the offer and brought suit, challenging the state's ability to grant an easement over the entirety of his leasehold property. Id.

The Alaska Supreme Court looked closely at the contract provision addressing rights-of-way and concluded that the provision was ambiguous, requiring the Court to supply its own interpretation. Id. at 1048, 1049-1050. Ultimately, the Court concluded that the lease provision was intended to allow the state to grant an easement up to 100 feet wide, pursuant to the state statute declaring highways over public lands to be 100 feet wide. Id. at 1049, 1051. The Court then held that Wessells was entitled to the compensation defined in the lease provision for a 100-foot wide route through the leasehold property, but that Wessells was entitled to a different amount of compensation, based on Wessells' leasehold interest in the property, for the remainder of the leased property. Id. at 1051-1052.

Finally, Lake Pleasant Group v. United States, 40 Fed. Cl. 647 (Fed. Cl. 1998) ("LPG") is a case decided by the U.S. Court of Federal Claims. Lake Pleasant Group had purchased a piece of property from its predecessors in interest that had been purchased from Arizona's state trust lands. LPG, 40 Fed. Cl. at 648-649. The property was surrounded on all sides by other state trust lands, and the previous owners had been granted a temporary right-of-way from the State Lands Department for access to the property. After purchasing the property, Lake Pleasant Group continued the former owners' efforts to obtain a permanent right-of-way from the Arizona State Land Department to maintain access to the property once the temporary right-of-way expired. Id. However, before the application for a permanent right-of-way was processed, the United States reacquired the surrounding trust lands as part of a dam and aqueduct project, then denied Lake Pleasant Group's application for a right-of-way. Id. at 649. Lake Pleasant Group brought suit alleging that the denial of the application denied Lake Pleasant Group of its property without compensation. Id. at 648-649.

The original court granted summary judgment to the defendant, a decision that was appealed to the U.S. Court of Appeals for the Federal Circuit, which overturned and remanded back to the original court for further proceedings. Id. at 648. One of the issues on which the appellate court reversed the summary judgment was on the question of whether the Lake Pleasant Group's predecessor in interest had paid sufficient compensation for an implied easement by necessity at the same time it purchased the property. Id. at 651. While the outcome of this case, which hinged on a second summary judgment motion, is not relevant to this discussion, it does highlight another pair of courts that have looked at the value of an easement or right-of-way interest as something separate and distinct from the value of a fee simple interest in a related property. See id. at 653.

While the above cases do not provide a formula for how to determine the full market value of a right-of-way or an easement, they do illustrate the principle that courts recognize different interests in land correlate with different values for those interests. A qualified real estate appraiser would be an appropriate expert to explain the process used to determine the market value of a right-of-way; however, it seems possible that the appraised or full market value for an easement would differ from the appraised or full market value of the fee simple interest in the same property. If the full market value of the interest being disposed of is obtained by and paid to the trust, then it would ultimately be up to a court to analyze and conclude whether the obligations to the trust had been satisfied.