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No. 22-002

STATE OF NEBRASKA
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FEB 25 2022

DEPT. OF JUSTICE

SUBJECT: Constitutionality of Legislation Providing for the Sale and Re-acquisition of Educational Lands by the State Board of Educational Lands and Funds Under Certain Circumstances and Conditions (LB 711).

REQUESTED BY: Senator Lynne Walz
Nebraska State Legislature

WRITTEN BY: Douglas J. Peterson, Attorney General
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INTRODUCTION

LB 711 (2022) proposes to require the State Board of Educational Lands and Funds ["Board"] to sell school lands to lessees for economic development, provided that the buyer increases the appraised value of the land by double sometime during a five-year period after purchase. The bill provides that school lands shall be sold pursuant to public auction to the lessee or someone else who is willing to enter into an agreement to increase the land by double sometime during a five-year period after the sale. LB 711 further provides that, should the successful buyer fail to double the appraised value of the land, the Board shall reacquire the land at the land's appraised value based upon its current use rather than the land's fair market value. Additionally, LB711 provides that the Board may not sell tracts of land smaller than 40 acres.

Your opinion request letter expresses concerns that LB 711:

1. Permits the Board to sell school lands only when the purchaser intends to use the land for economic development;
2. Requires that the appraised value of the school lands to be sold shall be based on the "current use" of the land and not the highest and best use of the land;
3. Limits the Board's ability to sell tracts smaller than 40 acres, or to allow tracts smaller than 40 acres remaining after sale;
4. Requires the Board to sell a property upon the request of a lessee within 120 days after the board's acceptance of the agreement; and
5. Requires the Board to reacquire school lands if the valuation goals are not met by the purchaser within five years.

With respect to these concerns, you ask us to address whether these provisions unconstitutionally hamper and limit the Board's ability to fulfill its fiduciary duty to manage the Board's property for the benefit of the State's school children.

BACKGROUND

On April 19, 1864, the U.S. Congress passed, and President Abraham Lincoln signed the Enabling Act. (U.S. Stat. at Large, Vol. 13, p. 47.) The Enabling Act allowed the people of Nebraska to form a Constitution and State Government and granted the State of Nebraska admission into the Union on an equal footing with the original States. Section 7 of the Enabling Act provides:

And be it further enacted, that sections number sixteen and thirty-six in every township . . . , shall be, and are hereby granted to said State for the support of the common schools. (U.S. Stat. at Large, Vol. 13, p. 47).

Thereafter, the people of Nebraska did form a Constitution and State Government and by proclamation of then President Andrew Johnson, the State of Nebraska was admitted to the Union on March 1, 1867.

Neb. Const. art. VII, § 6, provides, in relevant part:

No lands now owned or hereafter acquired by the state for educational purposes shall be sold except at public auction under such conditions as the Legislature shall provide. The general management of all lands set apart for educational purposes shall be vested, under the direction of the Legislature, in a board of five members known as the Board of Educational Lands and Funds.

The Nebraska Supreme Court has long recognized that “[t]he public school lands of the state are trust property and the state is required to administer them as such for the benefit of the common schools of the state.” *State ex rel. Ebke v. Board of Educ. Lands and Funds*, 154 Neb. 244, 247, 47 N.W.2d 520, 522 (1951) [“*Ebke*”]. The Court in *Ebke* recognized that

[b]y constitutional provision the lands set aside for the support of schools by the federal government are held in trust by the state. . . . These lands, therefore, are subject to the rules of law applicable to the handling of trust estates because of the status assigned to them by the Constitution. *Id.* at 248, 47 N.W.2d at 522-23.

Discussing the authority of the Legislature to provide for the sale of school lands, the *Ebke* Court stated:

That the Legislature has the power to provide the method of administering the public school lands of the state as a trust is not subject to question. But the method provided must be one which is within the law governing the administration of trust estates. The designation of these lands as a trust in the Constitution has the effect of incorporating into the constitutional provision the rules of law regulating the administration of trusts and the conduct and duties of trustees. A breach of trust in such a situation is in effect a violation of the constitutional provision and has the effect of invalidating the legislation authorizing the breach. *Id.* at 254-55, 47 N.W.2d at 525.

The fiduciary duty placed on the administration of educational lands was also recognized in *Propst v. Board of Educ. Lands and Funds*, 156 Neb. 226, 233-34, 55 N.W.2d 653, 657 (1952), where the Court stated:

The school lands were received and are held in trust by the State of Nebraska for Educational purposes. The state as trustee of the lands and of the income therefrom is required to administer the trust estate under the rules applicable to trustees acting in a fiduciary capacity. The title of the lands is not vested in the state with all of the ordinary incidents of other titles, but the title thereto was granted to and vested in the state upon an express trust for the ‘support of common schools’ with no right or power of the state to use, dispose of, or alienate the lands or any part thereof, except as allowed by the Enabling Act and the Constitution.

In Op. Att’y Gen. No. 91052 (June 7, 1991), this office summarized these principles as follows:

[I]t is within the authority of the Legislature to direct the sale of public school lands under such conditions as the Legislature shall provide. It must be noted however, the general management of the lands is vested in the Board of Educational Lands and Funds The power of the Legislature to direct the sale of educational lands is not without limits. In directing the sale of trust property, the Legislature may not

require the sale in a manner which would cause the Board to violate the fiduciary duties which bind the management of educational lands by the Board. . . . Consequently, the State as trustee of the lands and of the income therefrom, is required to administer the trust estate under the rules of law applicable to trustees acting in a fiduciary capacity.

ANALYSIS

Considering this background, we will proceed to examine each of your concerns regarding the constitutionality of LB 711.

1. Is it constitutional to limit sales of school land to purchasers that intend to use the land for economic development?

Response: No.

LB 711, Section 2 provides that “[t]he Board of Educational land and funds shall review and set priorities for the sale of lands covered by leases expiring each year, giving the highest priority to those lands which it determines, considering all relevant factors, can be sold to the best advantage for purposes of economic development.” (emphasis added).

The most obvious concern about this provision is that it violates the state’s duty as trustee to act solely in the best interests of the beneficiaries of the trust. See Neb. Rev. Stat. § 30-3867(a) (2016) (“A trustee shall administer the trust **solely** in the interests of the beneficiaries.”) (emphasis added). In this case, the beneficiaries are the children of the common schools.

LB 711, Section 3 appears to change Nebraska law to permit the sale of school lands only if the purchaser agrees to use the land for “economic development.” Sections 1, 2, 3 and 4. The original language of this section generally authorizes sales of school land. The proposed language appears to provide that all sales of school lands are limited to those purchasers who intend to use the land for economic development and who are willing to enter into an agreement to develop the land for economic development and double the appraised value of the land within five years. This provision restricts the Board from selling to anyone else who intends to use the land for farming, ranching or any other purpose that does not constitute economic development. By limiting the pool of prospective bidders, LB 711 results in the Board receiving less money than the property might otherwise bring when all prospective bidders are permitted to participate in the bidding. “A trustee is required to dispose of trust property upon the most advantageous terms which it is possible for him to secure for the benefit of the cestui que trust whom he represents.” *Ebke*, 154 Neb. at 249, 47 N.W.2d at 523. “The duty of loyalty requires a trustee to administer the trust solely in the interests of the beneficiaries. *In re Estate of Stuchlik*, 289 Neb. 673, 688, 857 N.W.2d 57, 69 (2014). Limiting the sale of school lands to only

buyers that propose to use the land for economic development violates the state's duty of loyalty to the beneficiaries of the trust.

Further, the "[s]tate, as trustee of public school lands, is without power through legislative means or otherwise to bestow a special benefit upon any person or corporation, public or private, at the expense of the *cestui que trust*, the public school system of the state." *State Bd. of Educational Lands and Funds v. Jarchow*, 219 Neb. 88, 99, 362 N.W.2d 19, 26 (1985) (quoting *State v. Platte Valley Public Power and Irr. Dist.*, 143 Neb. 661, 664, 10 N.W.2d 631, 633 (1943) (emphasis in original)). LB 711's requirement that school lands be sold only for economic development benefits the developer of the lands, and it does so at the expense of the *cestui que trust*. In other words, it violates the state's duty of loyalty as a trustee of the school lands by bestowing a benefit on a developer at the expense of the education of the state's school children. If the school lands can be developed and their value doubled within five years, the opportunity to develop the property and benefit from the increase in value belongs to the trust, not a third-party purchaser.

Again, the lands set aside for the public schools "by Constitution and congressional act, belong to the public school system of the state and the state is but the trustee thereof." *State ex rel. Johnson v. Central Neb. Public Power & Irr. Dist.*, 143 Neb. 153, 167, 8 N.W.2d 841, 849 (1943). The state, under the guise of economic development, cannot transfer the benefit of developing school lands from the trust to a private developer. The state as trustee owes a duty to the beneficiaries to maximize the income and value of the trust. It may not choose economic development over judicious administration of the assets for the benefit of the trust.

2. Is it constitutional to require that the appraised value of the school land to be sold must be based on the "current use of the land" rather than the "highest and best use" of the property?

Response: No.

The bill provides that that the "appraised value" of school lands subject to sale is to be determined based on the "current use of the land." LB 711, Section 1. The bill eliminates language currently in § 72-257 providing that school land sold at public auction "may be appraised for purposes of sale in the same manner as privately owned land by a certified general real property appraiser appointed by the board...." *Id.* The bill does not define what "current use of the land" means or how an appraisal is to be made based on such use.

It is our understanding that a valuation based on the current use of property is considered a hypothetical condition or restricted use for valuation purposes. Such valuation method does not arrive at the highest and best use which determination is necessary to obtain the fair market value of the land. The net effect of using a hypothetical condition or restricted use is to value the property at less than its fair market value. A reduced valuation gives the prospective buyer a benefit at the expense of the trust.

“All actions of the trustee must be in the interest of the beneficiaries and no one else.” *In re William R. Zutavern Revocable Trust*, 309 Neb. 542, 557, 961 N.W.2d 807, 820-21 (2021). Requiring a valuation and sale of trust property based on the “current use of the land” rather than the fair market value of the land constitutes a breach of the fiduciary duties of a trustee to act in the best interests of the trust.

In a 2014 decision, the Nebraska Court of Appeals found that a trustee breached his fiduciary duty to beneficiaries by failing to ascertain the fair market value of trust property prior to the sale, failing to promptly offer the property for public sale, and mistakenly giving one beneficiary an opportunity to purchase the property under the assumption that she had an active option. *In re Louise V. Steinhoefel Trust*, 22 Neb. App. 293, 854 N.W.2d 792 (2014). The court noted that “[a] breach of trust includes every omission or commission which violates in any manner the obligation of carrying out a trust according to its terms.” *Id.* at 299, 854 N.W.2d at 799.

The highest and best use of real estate is the valuation method generally accepted, and used, by real estate appraisers. Valuation of school lands based on “current use of the land” would exclude from consideration any value of the trust property due to future development value, location, and other unique characteristics of the property. This would result in the trust receiving less than the fair market value of school land, and essentially surrenders any added value to the buyers, to the detriment of the trust.

Finally, LB 711, Section 6 amends Neb. Rev. Stat. § 72-258.02 to state “appraised value means the value as determined by a certified general real property appraiser in the same manner as the value is determined for privately owned land.” As a practical matter, we do not believe a certified general real property appraiser would be able to render an appraisal based on the “current use” of the property. Rather, a certified general real property appraiser is required to consider other factors to determine the property’s fair market value based on its highest and best use and would likely decline to render an appraisal based only on the “current use” of the property.

3. Is it constitutional to limit the Board’s ability to sell tracts smaller than 40 acres, or which results in tracts smaller than 40 acres remaining after sale?

Response: No.

LB 711, Section 2 appears to preclude the Board from selling any property of less than 40 acres or to prohibit dividing land to be sold if it results in a tract of less than 40 acres remaining unsold. We have been advised that the Board presently owns many parcels of less than 40 total acres. LB 711 appears to prohibit the Board from selling any of those parcels, for any reason, at any price. We have been informed that the Board currently sells small, orphaned parcels split off from the main property by a highway. Those parcels are usually less than 40 acres. Although the Board pays taxes on these smaller parcels, the Board typically cannot rent or otherwise use those parcels.

While selling these small tracts may be in the best interests of the trust, LB 711 prohibits the Board from doing so to the detriment of the beneficiaries of the trust. Additionally, this provision would prevent the Board from developing properties next to communities or golf courses, dividing them into lots, etc., and selling them to the trust's best advantage. Additionally, it would prevent the Board from selling off acreages, pivot corners, or farmsteads, even if such sales would be in the best interests of the Trust. We believe this prohibition would prevent the Board from meeting its fiduciary obligation to maximize the income and value of the trust's assets.

4. Is it constitutional to require that the Board sell a property upon the request of a lessee within 120 days after the board's acceptance of the agreement?

Response: No.

LB 711, Section 3 appears to allow a present lessee to force the sale of any tract of school land (not just the tract the tenant is currently leasing) within 120 days. LB 711 does not provide any exception for existing leases nor does it allow the delay of the sale to coincide with the termination of the lease presently on the property. This provision would require the Board to terminate current leases early. This may result in litigation against the Board based on a breach of contract. This provision removes the Board's discretion in these cases even though such action may not be in the best interests of the Trust.

Requiring the sale of school lands within 120 days after the request of a lessee hampers the Board's ability to exercise reasonable care and due caution in violation of the Board's duties as a trustee. "A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution." Neb. Rev. Stat. § 30-3869 (2016). This duty includes the ability to decide if, and when, trust assets should be sold. To require a sale at the discretion of the tenant infringes on the Board's duties as a trustee of the school lands.

In 1949, our office was asked if the state could amend the statutes governing the sale of school lands to grant a preference to the leaseholder to purchase the lands at the highest bid made at public auction. 1949-50 Rep. Att'y Gen. 83 (Feb. 7, 1949). In that opinion, we stated:

To grant a special privilege to the lessee to purchase the lands at the highest bid would not be a sale to the highest and best bidder since the phrase "public auction" as used in our Constitution, and as above defined, clearly contemplates that the one who make the highest and best bid would receive title to the real estate free from the right of any other person to take the benefit of his bid from him simply by equaling the amount of his bid. *Id.*

Finally, "a trustee owes beneficiaries of a trust his undivided loyalty and good faith, and all of his acts as trustee must be in the interests of the cestui que trust and no one

else.” *Ebke*, 154 Neb. 244, 249, 47 N.W.2d at 523. This provision in LB 711 acts to thwart the Board’s fiduciary duty of loyalty and good faith to the best interests of the beneficiaries and only the beneficiaries.

5. Is it constitutional to require the Board to “reacquire” certain property if the goals were not met by the purchaser?

Response: No.

LB 711, Section 3 requires that the successful bidder enter into an agreement to improve or develop the land within one year after date of purchase. The section further provides that, if the appraised value of the land is not twice as much as the purchase price at some point within five years after the date of purchase, the Board “shall take all actions necessary to reacquire such land for the State of Nebraska as educational land” and “shall pay the purchaser the appraised value for the land...determined as of the date of the failed condition.” *Id.*

“The Legislature is authorized to provide by statute the terms upon which the public school lands of the state may be sold, but such terms must be consonant with the duties and functions of a trustee acting in a fiduciary capacity. It is the duty and function of a trustee to avoid unnecessary risks of loss and at the same time to obtain a maximum return to the trust estate consistent with the avoidance of such risks.” *Banks v. State*, 181 Neb. 106, 123, 147 N.W.2d 2d 132, 141 (1966) (J. Carter, concurring). “A trustee shall administer the trust as a prudent person would, by considering the purposes, term, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.” Neb. Rev. Stat. § 30-3869 (2016). Also, “[a] trustee shall take reasonable steps to take control of and protect the trust property.” Neb. Rev. Stat. § 30-3874 (2016).

The reacquisition requirement in LB 711 violates the State’s duty to properly administer school lands in a prudent manner as it prevents the Board from considering whether such acquisition is in the best interests of the Trust. For example, it would be a violation of the Board’s fiduciary duty if it is required to assume ownership of a “development” that was a failed attempt at economic development. The property in such a failed venture could be abandoned or damaged. A trustee should not be forced to accept contaminated or otherwise undesirable property. Additionally, it would be a breach of fiduciary duty for the Board to reacquire a failed going concern if the Board lacked the ability to properly manage the going concern. It would not be a reasonable step for a trustee to accept lands that are a liability and constitute a drain on trust assets.

Finally, under current law, the Board is without funds or authority to reacquire the property from the buyer. Neb. Rev. Stat. § 79-1035.02 (2014) requires that income funds be placed in the temporary school fund which are then distributed to the common schools. The entire balance of the temporary school fund shall be used exclusively for the maintenance and support of the common schools. The expenditure of the Trust’s regular income

is governed by Neb. Rev. Stat. §§ 72-232.02, 77- 232.03, 77-232.04, 77-232.06, 77-232.07, and 77-240.08 (2018). None of these sections authorize the Board to expend funds to reacquire school lands.

Neb. Rev. Stat. § 79-1035.01 (2014) requires that proceeds from land sales be deposited in the permanent school fund and invested in perpetuity in trust for the benefit of the common schools. Regarding the deposit of sale proceeds in the permanent fund, that issue is governed by Neb. Rev. Stat. §§ 72-259(2) and 72-268 (2018). There are no statutes empowering the Board to withdraw funds from the permanent fund to reacquire school lands. Thus, the Board is without authority to use the money from either fund to reacquire the land from the buyer.

CONCLUSION

For the reasons stated above, we conclude that LB 711 is unconstitutional in several respects. The proposed legislation would encroach on the Board's duties as trustee to administer the school lands. As written, LB 711 would violate the fiduciary duties placed on the state by the constitution.

Sincerely yours,

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