



STATE OF IDAHO  
OFFICE OF THE ATTORNEY GENERAL  
LAWRENCE G. WASDEN

**ATTORNEY GENERAL OPINION NO. 09-1**

To: George Bacon  
Director, Idaho Department of Lands  
**STATEHOUSE MAIL**

Per request for Attorney General's Opinion

You have requested an Attorney General's Opinion regarding the constitutionality of those provisions in Idaho Code § 58-310A exempting single family cottage site leases from the public auction requirements of Article IX, § 8, of the Idaho Constitution and substituting a "market rent" requirement in lieu of public auctions.

**QUESTIONS PRESENTED**

1. Can the Idaho Legislature, pursuant to Idaho Code § 58-310A, exempt leases of state endowment lands for "single-family, recreational cottage sites and homesites" from the public auction requirement of Article IX, § 8, of the Idaho Constitution?
2. Are the Idaho State Board of Land Commissioners ("Land Board" or "Board") cottage site leasing rules, which allow a lessee to retain a percentage of the leasehold value<sup>1</sup> of a lease upon transfer, consistent with the Board's constitutional duty to secure the maximum long-term financial return for its beneficiaries?

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<sup>1</sup> The term "leasehold value" refers to the "value which accrues to a leasehold estate when the contract rent is below the market rent." IDAPA 20.03.13.010.06. The term "contract rent" refers to the rental rate specified in the cottage site leases (currently 2.5%). The term "market rent" refers to the rent that a cottage site would command if offered in a competitive and open market. Leasehold value can also be defined as the value of the bargain rent over the remaining lease term, discounted to present value. Bargain rent is the difference in value between contract rent and market rent.

## CONCLUSIONS

1. A reviewing court likely would conclude the Idaho Legislature does not have the authority to exempt leases of state endowment lands for single-family recreational cottage sites and homesites from the public auction requirement of Article IX, § 8, of the Idaho Constitution.
2. A reviewing court likely would conclude that the cottage site leasing rules, IDAPA 20.03.13, violate the constitutional mandate that endowment lands be managed solely for the financial benefit of endowed institutions. The rules allow leasehold values to accrue when contract rent is below market rent, then allow lessees to retain 90% of leasehold values upon assignment of the leases. A reviewing court is likely to find that the leasing rules impermissibly allowed lessees to receive over \$21 million from the assignment of leaseholds in the last six years that rightfully should have gone to the beneficiaries.

## BACKGROUND

The Land Board began leasing state endowment lands for residential cottage sites in 1924. The majority of the cottage site leases were issued in the mid 1940s and early 1950s. Minutes of Meeting of the Idaho State Bd. of Land Comm'rs, April 8, 1997, at 1. Trust assets include 354 cottage site lots on Priest Lake and 168 cottage site lots on Payette Lake. Each cottage site is owned in fee simple by the State of Idaho as trustee for the beneficiaries and is subject to the constitutional directive to provide the maximum long-term financial return to endowment beneficiaries. Idaho Const., art. IX, § 8. This system can be summed up as follows:

The state leases the lots, and lessees are authorized to construct and own single-family residences on the sites. The cottage sites are to be managed, like all endowment trust assets, to provide "maximum long term financial return" to the trust beneficiaries, primarily public schools.

Philip S. Cook and Jay O'Laughlin, Analysis of Procedures for Residential Real Estate (Cottage Site) Leases on Idaho's Endowment Lands at 1 (October 2008).

Rents for Priest Lake lots in 1945 were as low as \$10 per year. Cook and O'Laughlin at 4. From 1945 to 1988, rents were established using a flat rate with sporadic adjustments. Minutes of Meeting of the Idaho State Bd. of Land Comm'rs, April 8, 1997, at 1. Adjustments were made by calculating the leasehold value upon the assignment of leases, then dividing by three (to account for the fact that the lots were not usable part of the year), then multiplying by 7.5%, the average earnings the endowments were earning at the time. Minutes of Meeting of the Idaho State Bd. of Land Comm'rs, August 4, 1981.

In 1981, as recreational homes became more popular and accessible on a year-round basis, leasehold values began to increase. Lessees expressed the concern to the Board that the above-described formula, which tied rents to leasehold values, would result in "very large increases" in rent. Minutes of Meeting of the Idaho State Bd. of Land Comm'rs, August 4, 1981. In lieu of rent increases, the Board adopted the "premium rent" concept, whereby, upon assignment of a lease, the State "would get 10% of the leasehold value after the improvements were subtracted." *Id.* Premium rent was adopted so that when lessees sold leaseholds for value, "the State could share in the profit." Minutes of Meeting of the Idaho State Bd. of Land Comm'rs, October 13, 1981.

Rules for payment of premium rent were adopted by the Board in 1987. The rules acknowledge that leasehold value "accrues to a leasehold estate when the contract rent is below the market rent." IDAPA 20.03.13.010.06. Leasehold value is determined at the time of assignment of a lease by subtracting the value of the lessee's improvements and personal property from the full sales price. IDAPA 20.03.13.025. Upon sale, 10% of leasehold value is paid to the Board as premium rent. IDAPA 20.03.13.027.<sup>2</sup>

While cottage sites were subject to the public auction requirements of Idaho Code § 58-310, expiring leases were not advertised for auction. Only four applications to conflict a lease were ever received, and none resulted in an auction. Idaho Sen. Res. and Env't Comm., Minutes of February 9, 1990 at 2 (testimony of Dept. of Lands Director Stan Hamilton). Nonetheless, lessees remained concerned that the increased demand for recreational properties would lead to conflict auctions upon expiration of cottage site leases. Idaho Sen. Res. and Env't Comm., Minutes of March 7, 1990. Consequently, lessees sought, and the Idaho Legislature, in 1990, enacted, Idaho Code § 58-310A, which abolished the use of public auctions as a means of establishing market rents in lieu of a general requirement that the Land Board "ensure that each lot generates market rent throughout the duration of the lease." The legislation was silent as to the means to be used to determine market rent, leaving such determination to the discretion of the Land Board. Despite the concerns expressed by legislators during the hearings of the need for the Board to achieve a market rent to eliminate leasehold value, the Board has not amended its 1987 rules, which allow leasehold values to accrue due to disparities between contract rents and market rents.

Following the enactment of Idaho Code § 58-310A, the Land Board hired an appraiser to determine market rents for the cottage sites at Priest Lake and Payette Lake. The appraiser recommended rents ranging from 4.5% to 5.5%, depending on lot value. Minutes of Meeting of the Idaho State Bd. of Land Comm'rs, June 11, 1991. The Board, however, decided to maintain

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<sup>2</sup> The rule imposing premium rent stated that such rent was to be "required through December 31, 1992 or until contract rents have been increased to full market rents, whichever comes first." IDAPA 20.03.13.027. After December 31, 1992, however, the Board has continued to apply IDAPA 20.03.13.027 and include premium rent provisions in cottage site leases as a matter of Board policy.

annual rents at 2.5% of fee simple value, a rate that was established in 1988. *Id.* The 2.5% annual rental rate has remained in place since 1988, despite several appraisals and market rent studies concluding that the market rate is substantially above 2.5%. *See, e.g.*, John T. McFadden, Appraisal Report: Project Report with Comparable Sales for Priest Lake Cottage Site Appraisals at 24-25 (1998) (recommending a rate of 3.5% for cottage sites at Priest Lake); Bradford T. Knipe, Complete Appraisal, Self Contained Report and Market Analysis of 14 Payette Lake Cabin Sites at 156, 163 (1998) (recommending a rate of return between 4% and 6% for cottage sites at Payette Lake). In every report, the authors noted that the existence of leasehold values indicated that the 2.5% contract rental rate was below the market rate. McFadden at 22; Knipe at 151; Cook & O’Laughlin at 11; John Duffield, Final Report: Economic Analysis of the Values of Surface Uses of State Lands at 8 (1993).

While the nominal rental rate has remained at 2.5%, the effective rate in many years has been substantially less, due to Board decisions to freeze or phase in rent increases caused by substantial appreciation of fee simple values. *See, e.g.*, Minutes of Meeting of the Idaho State Bd. of Land Comm’rs, June 11, 1991, at 2 (retaining phase-in schedule of ten years); Minutes of Meeting of the Idaho State Bd. of Land Comm’rs, June 9, 1992, at 2 (staff comment that ten-year phase-in period for Payette Lake with maximum annual increase of 5.3% “would not reach the target value unless it is fixed statically at the 1992 level over that 10-year period”); Minutes of Meeting of the Idaho State Bd. of Land Comm’rs, December 4, 2007, at 1 (substituting motion to freeze Payette Lake rental rates at the 2007 value in lieu of motion to limit increase to 25%); Minutes of Meeting of the Idaho State Bd. of Land Comm’rs, June 19, 2008, at 5 (rejecting recommended 23% increase at Priest Lake and unspecified increase at Payette Lake and voting to implement 15% increase with report back to Board at December 2008 meeting); Minutes of Meeting of the Idaho State Bd. of Land Comm’rs, December 16, 2008, at 4 (rescinding 15% rent increase and voting to freeze rents at then-current levels).

## ANALYSIS

1. **A reviewing court is likely to find that the prohibition of conflict auctions in Idaho Code § 58-310A violates the requirement in Article IX, § 8, of the Idaho Constitution that all disposals of endowment lands must occur by public auction.**

Article IX, § 8, of the Idaho Constitution provides, in part:

The legislature shall, at the earliest practicable period, provide by law that the general grants of land made by congress to the state shall be judiciously located and carefully preserved and held in trust, subject to disposal at public auction for the use and benefit of the respective object for which said grants of land were made . . . .

(Emphasis added.) The first statutes defining the duties of the Land Board implemented the public auction requirement, in part, by providing that, where two or more people apply to lease the same land, the Board must auction off and lease the lands to the applicant who will pay the highest annual rental. 1905 Idaho Sess. Laws 138, codified as amended, Idaho Code § 58-310.

Prior to 1990, cottage site leases were subject to the conflict auction requirement of Idaho Code § 58-310 when two or more people sought to lease the same parcel. In response to lessee concerns that they might lose “any amount they spent to procure and maintain the leases except the value of their improvements,” Idaho H. Res. and Conservation Comm. Hearing of March 7, 1990 (attachment, “Legislative Fact Sheet in Support of SB 1516,” prepared by Payette Lakes Cabin Owners Association and Pilgrims Cove Association), the Idaho Legislature, in 1990, enacted Idaho Code § 58-310A, which declares “that leases for single family, recreational cottage sites and homesites shall not be subject to the conflict application and auction provisions of sections 58-307 and 58-310, Idaho Code.” The legislative findings contained in 58-310A expressly state:

(b) That single family, recreational cottage sites and homesites have typically been held by the same family, sometimes for as long as fifty (50) years;

....

(e) That, in the case of single family, recreational cottage sites and homesite leases, the conflict application and auction procedure have caused considerable consternation and dismay to the existing lessee at the prospect of losing a longtime lease . . . .

Idaho Code § 58-310A(1) (emphasis added).

Prior to the enactment of Idaho Code § 58-310A, Representative Wayne Sutton requested the Attorney General to prepare a legal guideline addressing the bill’s constitutionality. The legal guideline prepared by the Attorney General’s office expressed the concern that:

[I]n light of the legislative findings [in § 58-310A] it may be inferred that the rejection of conflict applications . . . is designed, at least in part, for the benefit of long term, single family lessees. . . . The finding could be interpreted as implying an intent to benefit someone other than the beneficiaries of the trust, resulting in the bill being overturned as a breach of the state’s duty of undivided loyalty to the beneficiaries of the endowment lands trusts.

1990 Idaho Att’y Gen. Ann. Rept. 120, 125. The guideline further concluded that, based upon then-available precedents, it was “possible to interpret article 9, section 8, as vesting in the legislature the discretion to lease public lands by methods other than by public auction,” but the guideline also “cautioned that this conclusion is somewhat tentative, given that it is supported

only by ambiguous statements of the Idaho Supreme Court, the delegates to the constitutional convention, and the early legislature.” Id.

Since publication of the legal guideline, the Idaho Supreme Court has clarified both the duty of undivided loyalty to the beneficiaries and the public auction requirement of Article IX, § 8, of the Idaho Constitution. These decisions of the Idaho Supreme Court cast serious doubt on the constitutionality of Idaho Code § 58-310A. The evolution of the case law as related to the interpretation of Article IX, § 8, is set forth in the following section.

**a. Court decisions interpret Article IX of the Idaho Constitution to impose a duty of undivided loyalty on the Legislature and Land Board to manage endowment lands for the sole benefit of endowed institutions.**

Article IX, § 7, of the Idaho Constitution provides that the Board shall “have the direction, control and disposition of the public lands of the State, under such regulations as may be prescribed by law.” Article IX, § 8, of the Idaho Constitution imposes a duty upon the Board to provide for the rental of state lands “under such regulations as may be prescribed by law, and in such manner as will secure the maximum long-term financial return to the institution to which granted.”

While Article IX, § 8, of the Idaho Constitution directs the Land Board to “secure the maximum long-term financial return” for endowed institutions, it also authorizes the Legislature to regulate the process by which the Board exercises its powers and duties. Such regulations must be consistent, however, with the constitutional duties imposed on the Board if a regulation “goes beyond the scope of regulating the action of the board in the discharge of its constitutional duties, it is void.” Rogers v. Hawley, 19 Idaho 751, 115 P. 687, 690 (1911).

The Idaho Supreme Court, in interpreting Article IX, § 8, has described public endowment land as a trust *res* overseen by the Land Board as trustee, and the court has held that principles of basic trust law apply to the Board in the exercise of its constitutional and statutory duties. Moon v. State Bd. of Land Comm'rs, 111 Idaho 389, 393, 724 P.2d 125, 129 (1986). The Board’s obligation to trust beneficiaries is “of the most sacred and highest order.” State ex rel. Moon v. State Bd. of Examiners, 104 Idaho 640, 642, 662 P.2d 221, 223 (1983).

Since the enactment of Idaho Code § 58-310A, the court has emphasized that the trust terms in Article IX of the Idaho Constitution prohibit the Legislature from directing the Board to act for the benefit of any party other than the trust beneficiaries. In Idaho Watersheds Project v. State Bd. of Land Commissioners, 133 Idaho 64, 982 P.2d 367 (1999) (hereinafter IWP III), the Court reviewed the constitutionality of Idaho Code § 58-310B, which authorized the Board, in awarding grazing leases, to consider not only the direct return to the endowment beneficiaries but also indirect benefits to the endowment beneficiaries resulting “from tax revenues from all sources generated by the lessee’s proposed activities on the leasehold and those activities related

thereto.” Idaho Code § 58-310B(6)(e). The stated purpose of the legislation was to “support the endowed institutions by encouraging a healthy Idaho livestock industry so as to generate related business and employment opportunities on a state and local level, thus supporting additional sales, income and property taxes.” Idaho Code § 58-310B(2)(a). In holding 58-310B to be unconstitutional, the court quoted the provision in Article IX, § 8, that state lands are to be:

judiciously located and carefully preserved and held in trust, subject to disposal at public auction *for the use and benefit of the respective object for which said grants of land were made . . . .*

133 Idaho at 67, 982 P.2d at 370. The court concluded that “by attempting to promote funding for the schools *and* the state through the leasing of school endowment lands,” Idaho Code § 58-310B violated the mandate of Article IX, § 8, that the only allowable criteria for awarding leases is the “‘maximum long term financial return’ to the schools.” *Id.*

In light of the IWP III decision, it is likely that a court would hold the stated purpose of § 58-310A violated the duty of undivided loyalty to trust beneficiaries, since, as discussed above, the elimination of the public auction requirement was done explicitly for the benefit of the lessees, not the benefit of the trust beneficiaries. The mere fact that the Legislature instructed the Board to secure “market rent” in lieu of conflict auctions would not be sufficient to salvage the statute: In IWP III, the court gave no weight to legislative findings that providing a stable livestock industry would ultimately “enhance long-term financial returns to the endowed institutions.” Idaho Code § 58-310B.

**b. The Idaho Supreme Court has held that Article IX, § 8, mandates public auctions for all leases of state lands in the event of conflicting applications.**

The public auction requirement of Article IX, § 8, which applies to all “disposals” of endowment lands, was first interpreted in Tobey v. Bridgewood, 22 Idaho 566, 127 P. 178 (1912), which addressed a permit to appropriate water on state lands. There, in a general discussion of provisions applying to the disposition of state lands, the court suggested that both sales and leases were dispositions of state land and subject to the “disposal at public auction” requirement of Article IX, § 8. 22 Idaho at 582-84, 127 P. at 183-84.

Tobey was overruled in Idaho-Iowa Lateral & Reservoir Co. v. Fisher, 27 Idaho 695, 151 P. 998 (1915). The issue before the court was whether easements and rights-of-way were subject to the public auction requirement. The court reconciled a perceived conflict between the public auction requirement of Article IX, § 8, and the eminent domain provisions of Article IV, § 1, by holding that if the requirement of a “public auction at a minimum price of ten dollars per acre be construed to apply only where a fee-simple title is to be conveyed, then the two sections . . . are reconciled, and both are made effective.” *Id.* at 706, 151 P. at 1001.

Several years later, in East Side Blaine County Live Stock Ass'n v. State Bd. of Land Commissioners, 34 Idaho 807, 198 P. 670 (1921), the court had before it a challenge to a Land Board action refusing to hold a conflict auction when there were competing applications to lease certain grazing lands. The court upheld a writ of mandate requiring the Board to offer the lease at public auction. As authority for the writ, it cited both Article IX, § 8, and two statutes requiring the Board to hold a conflict auction upon receiving competing lease applications. The Court, by holding that the “provisions of the Constitution and statutes above referred to made it the duty of the State Board of Land Commissioners . . . to offer the lease of said lands at auction to the highest bidder,” appeared to conclude that the public auction provisions of Article IX, § 8, apply to grazing leases. It did not, however, explicitly overrule the holding in Idaho-Iowa Lateral & Reservoir Co. limiting the public auction requirement to fee simple transfers.

The above-described decisions were the best guidance available at the time of the passage of Idaho Code § 58-310A. As noted in the Attorney General guideline discussed above, such decisions left open an interpretation of Article IX, § 8, that excluded leases from public auction requirements. Since the enactment of § 58-310A, however, a series of decisions has clarified that the public auction requirement of Article IX, § 8, does apply to leases of state endowment lands.

The first case, Idaho Watersheds Project, Inc. v. State Bd. of Land Comm'rs, 128 Idaho 761, 918 P.2d 1206 (1996) (hereinafter IWP I), involved a conflict auction between IWP and a rancher, who was a long-standing lessee of the property in question. The Board awarded the lease to the rancher, despite his refusal to make a bid at the conflict auction. The court held that:

The Board does not have the discretion to grant a lease to an applicant who does not place a bid at an auction, *based upon Idaho's constitutional and statutory mandate that the Board conduct an auction.* Idaho Const. art. IX, § 8; I.C. § 58-310.

IWP I, 128 Idaho at 766, 918 P.2d at 1211. Thus, while the decision hinged on the auction requirements of Idaho Code § 58-310, the court explicitly identified a “constitutional . . . mandate” that the Board conduct public auctions for leases.

Following the decision in IWP I, an attempt was made to amend Article IX, § 8, by changing the “disposal at public auction” language to “sale at public auction.” H.J.R. No. 6, 1998 Sess. Laws 1366, 1367. The effort ultimately failed due to procedural errors. *See Idaho Watersheds Project v. State Bd. of Land Comm'rs*, 133 Idaho 55, 982 P.2d 358 (1999) (hereinafter IWP II) (holding H.J.R. No. 6 unconstitutional for presenting multiple amendments in single ballot). The effort demonstrates, however, that IWP I was widely understood to interpret the “disposal at public auction” requirement of Article IX, § 8, to apply to leases. For example, the statements for the proposed amendment specifically stated that “[a] lease is

sometimes promoted as being within the term ‘disposal,’” and stated that the proposed change would clarify that “a lease is not a permanent disposition and should be distinguished from ‘sale.’” Id. at 63, 982 P.2d at 366.

The issue of whether the public auction language applies to leases was again addressed in IWP III. There, the court held that language in Article IX, § 8, providing that endowment lands are “subject to disposal at public auction for the use and benefit of the respective object for which said grants of land were made” prohibited legislation requiring that grazing leases be awarded based on both direct returns to beneficiaries and tax revenues to the State. In holding § 58-310B to be unconstitutional, the court quoted the provision in Article IX, § 8, that states endowment lands are to be:

judiciously located and carefully preserved and held in trust, subject to disposal at public auction *for the use and benefit of the respective object for which said grants of land were made . . . .*

IWP III, 133 Idaho at 67, 982 P.2d at 370. While the court did not explicitly hold that the constitution required public auctions of leases, the “use and benefit” language relied upon by the court is directly tied to the “disposal at public auction” requirement, and the fairest reading of the court’s opinion is that leases are disposals of endowment property and thus subject to all requirements of Article IX, § 8.

In sum, the IWP decisions establish two important precedents that likely would lead a reviewing court to declare unconstitutional those provisions of Idaho Code § 58-310A prohibiting public auctions for cottage site leases. IWP III establishes that the Court will closely examine any statute that directs action for the benefit of lessees rather than for the benefit of endowed institutions. As discussed above, the legislative findings in Idaho Code § 58-310A plainly declare that the Legislature’s intent was to provide relief to lessees from the “considerable consternation and dismay” that accompanied the “prospect of losing a long-time lease.” Such findings establish that the Legislature’s intent was to provide relief to lessees, not to maximize endowment income. The legislative history affirms such intent. For example, during the hearings on Senate Bill 1516, the bill ultimately enacted as Idaho Code § 58-310A, Senator Vance stated:

[W]hat I want to do is translate this from lawyer to farmer. I’ll tell you what this is. The legislative finding is that more than one person wants the lease. The first person wants to stay because he’s been there a long time. So the State is required, currently, the State is required to auction and the lessee may be upset after such a long time, that someone else may be interested in the lease. So since the Board has never had occasion to follow the law in this matter, and since the constitution requires that the State manage the land to experience maximum gain. These are

point by point, you can read it yourselves. And finally that since we need to maximize long-term gains, it is hereby declared that we aren't going to do it anymore. That's what they're saying. It's the craziest thing I've ever witnessed. I can't believe it.

Idaho Sen. Res. and Env't Comm., Hearing of February 16, 1990 (tape of hearing on file in Legislative Council Office) (emphasis added). Given the plain language of the findings and the legislative history, it is likely a reviewing court would conclude that § 58-310A was enacted to benefit lessees rather than beneficiaries, a result prohibited by Article IX, § 8. Even if the court failed to strike down § 58-310A on the basis of the Legislature's stated intent to benefit lessees, it likely would conclude, in light of IWP I and IWP III, that public auctions are mandated by Article IX, § 8, of the Idaho Constitution, and, therefore, it was beyond the Legislature's authority to exempt cottage site leases from public auction requirements.

- 2. A reviewing court likely would conclude the Land Board's cottage site leasing rules, by allowing an impermissible shift of financial gains from beneficiaries to leaseholders, are inconsistent with the Board's constitutional duty to obtain the maximum long-term financial return for endowment beneficiaries.**

In addition to the facial conflict between Idaho Code § 58-310A and the public auction requirement of Article IX, § 8, a reviewing court likely would conclude that the Board's rules implementing § 58-310A have provided lessees an impermissible privilege in the form of a benefit from sales of leasehold value, which serves to the detriment of the state endowment trust beneficiaries in direct contravention of Article IX, § 8. While § 58-310A directs the Land Board to procure market rent, the Board's cottage site rules continue to allow leasehold values to accrue as the result of disparities between contract rents and market rents and, in turn, allow lessees to retain 90% of leasehold value at the time of transfer of a lease.

Prior to the enactment of Idaho Code § 58-310A, Article IX, § 8, and Idaho Code § 58-308 specifically entitled a lessee to be reimbursed in full only for the value of his improvements upon a subsequent re-leasing of the premises as a result of a conflict auction. All value in the appreciation of the property belonged rightfully to the endowment beneficiary. The State had the option, though never exercised, of capturing the value of property appreciation by procuring market rent through the use of conflict auctions upon the expiration or termination of a lease.

The passage of Idaho Code § 58-310A foreclosed the Board from using conflict auctions to establish market rent for cottage sites. Thus, the only open and competitive market that exists for cottage site leases is the private leasehold market, which allows lessees to gain private benefit from the failure of the Board to maintain contract rents at market rates. Free from the risk of conflict auctions, a substantial market for the sale of cottage site leaseholds has developed, and lessees have been allowed to reap most of the benefits of the increases in market appreciation.

The cottage site leasing rules expressly acknowledge that leasehold value “accrues to a leasehold estate when the contract rent is below the market rent.” IDAPA 20.03.13.010.06. Because contract rents were allowed to fall below the price buyers were willing to pay in an open market, buyers began buying leaseholds, paying the difference between contract rent and market rent, discounted to present value. The amounts at issue are substantial. According to a recent analysis by Idaho Department of Lands financial staff, 79 lease transfers occurred from 2003 through 2009, and the total value of leasehold interests for the 79 transfers was \$23,594,664, of which over \$21,000,000 went to lessees. If contract rents had been equivalent to market rent, this money would have gone to the trust beneficiaries.

The link between abolishment of conflict auctions and the enrichment of lessees at the expense of trust beneficiaries is found in the “Legislative Fact Sheet in Support of SB 1516” (ultimately, Idaho Code § 58-310A) submitted by the Payette Lakes Cabin Owners Association, Inc., and the Pilgrims Cove Association.

[F]orty six leases are scheduled to renew in 1990, and all of them are potentials for conflict bid applications. That is why it is absolutely critical for SB 1516 to pass this year. These lessees not only may lose their leases in a conflict bid, but the majority of lessees have paid for their leases and will lose substantial amounts of money. Lessees would lose that amount of money that they paid for their lease over and above the assessed value of their improvements. For example, a lessee who paid \$90,000 for his leasehold that contains \$40,000 of cabin and improvements would get paid for the \$40,000 of improvements if his lease was lost in a conflict bid. But, the lessee would lose the remaining \$50,000 that he had originally paid for his lease! One hundred percent of the money from a conflict bid goes to the state; the lessee is only reimbursed by the winner of the bid for the amount of the improvements on the lot. If a lessee paid \$115,000 for his lease that contained improvements of \$30,000, he would be reimbursed \$30,000 by the winning conflict bidder and would lose the remaining \$85,000 of his investment forever!

Idaho H. Res. And Conservation Comm. Hearing of March 7, 1990 (attachment entitled “Legislative Fact Sheet in Support of SB 1516”) (emphasis added). As the lessees correctly noted, prior to the enactment of Idaho Code § 58-310A, 100% of all sums bid for property in an open-market conflict auction would have been belonged, and should have been paid, to the trust beneficiaries in accordance with the requirements of the Idaho Constitution.

Ironically, many legislators, in hearings on the bill that became Idaho Code § 58-310A, expressed concern that lessees were reaping huge financial benefits from the assignment of leaseholds. For example, Senator Donesley, after hearing the director of the Department of Lands describe the process for lease assignments, stated:

[W]hat you've just described, while it sounds acceptable on its face, you've described the benefit of enjoying the property and then selling it for a profit after the enjoyment of the property. Somewhere in there is a slice of the state given that it is state property being enjoyed, it's appreciating and the profit from the sale which is going into private pocket and now we're having a bill to protect that kind of situation. So I was going along fine until you got to that last part, it looks to me like a double benefit.

Idaho Sen. Res. and Env't Comm., Hearing of February 16, 1990 (tape of hearing on file in Legislative Council Office). Senator Reed also expressed concerns regarding the sale of leasehold interests by lessees "without passing along to the state their fair rate." Id. Perhaps in response to such concerns, Senator Noh suggested that leasehold sales would "serve as a basis for appraisals of the value of the leases," to which Idaho Department of Lands Director Hamilton replied:

Mr. Chairman, there are relationships. First of all the leasehold interest exists because by classic economic theory, a leasehold exists when rentals, when contract rentals are lower than market rentals. And I think that is general first economics 101. So I think there is a relationship there. As rents go up, the leasehold values do come down. And there is a relationship there that can be determined.

Id. Director Hamilton's comments seemed to address the Senator's concerns over lessees profiting from lease sales by suggesting that contract rents would be adjusted to market rates, so that leasehold values would come down. Thus, it appears that the Legislature, in enacting Idaho Code § 58-310A, expected that the problem of lessees profiting from the assignment of leases would be corrected by requiring market rent.

Of course, as lessees have pointed out, not all lessees profit from the assignment of leaseholds, since most lessees have paid substantial amounts of money to purchase their leaseholds. For example, if a lessee buys a leasehold for \$90,000, then sells it several years later for \$90,000, such lessee gets only \$81,000 from the sale, since the State must be paid 10%, or \$9,000. Thus, lessees profit only when they are able to sell their leasehold for 10% over their original purchase price. Idaho H. Res. and Conservation Comm., Minutes of March 7, 1990 (attachment, "Questions and Answers Concerning Lease Lot Issues and SB 1516, prepared by Payette Lakes Cabin Owners Association and Pilgrims Cove Association). This fact, however, is beside the point. The concern that a reviewing court would likely focus on is not whether individual lessees profit but whether rent money that should be going to beneficiaries is going instead to lessees. This issue would be addressed by looking at gross leasehold values, not the net profits or losses of individual lessees.

The assignment of leaseholds for significant amounts of money demonstrates that Idaho Code § 58-310A, as implemented by the Board, has inhibited, rather than promoted, the receipt of market rent by the State. A reviewing court likely would conclude that the accrual and sale of substantial leasehold values, with the majority of the sales price going to lessees, is a violation of the Board's constitutional duty to secure the maximum long-term financial return to the endowment beneficiaries.

### **AUTHORITIES CONSIDERED**

#### **1. Idaho Constitution:**

Art. IX, § 7.  
Art. IX, § 8.

#### **2. Idaho Code:**

§ 58-308.  
§ 58-310.  
§ 58-310A.  
§ 58-310B.

#### **3. Idaho Administrative Rules:**

IDAPA 20.03.13.010.06.  
IDAPA 20.03.13.025.  
IDAPA 20.03.13.027.

#### **4. Idaho Cases:**

East Side Blaine County Live Stock Ass'n v. State Bd. of Land Commissioners, 34 Idaho 807, 198 P. 670 (1921).

Idaho-Iowa Lateral & Reservoir Co. v. Fisher, 27 Idaho 695, 151 P. 998 (1915).

Idaho Watersheds Project, Inc. v. State Bd. of Land Comm'rs, 128 Idaho 761, 918 P.2d 1206 (1996).

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LAWRENCE G. WASDEN  
Attorney General

**Analysis by:**

STEVEN STRACK  
ROBERT FOLLETT  
Deputy Attorneys General