Opinion No. 70-94

December 11, 1970

BY: OPINION OF JAMES A. MALONEY, Attorney General

TO: Mr. Robert G. Mead State Investment Officer State Investment Council P.O. Box 966 Santa Fe, New Mexico 87501

QUESTIONS

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1. May the State Investment Council invest state permanent funds in interest-bearing time deposits issued by banks and savings and loan associations?

2. May the State Investment Council invest state permanent funds in such time deposits bearing interest at 7 1/2 per cent annually, when rates of interest on securities issued by federal governmental agencies are from 8 1/2 per cent to 8 3/4 per cent?

3. If the conclusion to the second question is in the negative, but the State Investment Council does invest state permanent funds in such time deposits at rates of interest lower than those available in the competitive market, will the State Investment Council have breached the trust owed to the beneficiaries of the state permanent funds?

4. Are interest-bearing time deposits issued by banks and savings and loan associations corporate securities and if so, is the State Investment Council restricted in its investment in such securities?

5. Once the State Investment Council has determined to invest state permanent funds in such interest-bearing time deposits, may the Legislature constitutionally require that the state treasurer, the commissioner of banking and the director of the department of finance and administration first approve banks and savings and loan associations before the State Investment Council invests in such depositories?

CONCLUSIONS

1. See analysis.

2. No.

3. Yes.

4. See analysis.

5. There is a serious question.

OPINION

*{*163}* **ANALYSIS**

PART I: HISTORICAL BACKGROUND

Any discussion of state permanent funds and the purposes for which state permanent funds may be used must begin with an analysis of the New Mexico-Arizona Enabling Act. Act of June 20, 1910, ch. 310, 36 Stat. 557. A federal law passed by the United States Congress, the Enabling Act specifically requires that certain provisions be made a part of any constitution which the state adopts. Those provisions were in fact included in New Mexico's Constitution, but under the supremacy clause (U.S. Const. Art. VI, **§** 2), to the extent that Congress has the power under the United States Constitution to make these requirements, the provisions would be binding on the state regardless what the state's constitution said to the contrary. Sections 7 and 9 of the Enabling Act provide that the proceeds of sale of public lands shall become part of the permanent school fund of the state, and the income therefrom shall be used only for the maintenance of the common schools of the state. Section 10 of that Act requires that the public lands of the state be held in trust and that the proceeds from those lands shall be subject to the same trusts as the lands producing the proceeds.

The state permanent funds, over which the State Investment Council exercises investment jurisdiction, are derived from lands given by the United States to the Territory of New Mexico, in accordance with the Ferguson Act of 1898 (Act of June 21, 1898, ch. 489, Stat. 484), and from additional lands similarly granted by the Enabling Act of 1910 in anticipation of the conferring of statehood upon the territory. In all, more than thirteen million acres were granted to the state in this manner. After more than fifty some-odd years, the trusts still have more than nine million surface acres remaining.

Under the terms of these grants it was stipulated that such land, as well as all funds derived therefrom, were to be held in trust for the benefit of the common schools and other designated institutions of the state. By Article 13, Sections 1 and 2 of the New Mexico Constitution, the custody and control of these granted trust lands were entrusted to the Commissioner of Public Lands.

The purposes for which permanent funds may be used are specified in the Enabling Act, where the United States Congress required that each quantity of land with its proceeds be devoted to a particular object. Section 10 of that act leaves little question concerning the limitations which were imposed upon the people and government of New Mexico in the use of these lands and their proceeds. Specifically, the Enabling Act provides that the use of "said lands or any money or thing of value . . . derived therefrom, for any object other than that for which such *{*164}* particular lands . . . were granted or confirmed, shall be deemed a breach of trust." Enabling Act, **supra, §** 10.

The first case involving an attempt by the New Mexico Legislature to use state permanent funds for a purpose not provided for in the Enabling Act was **Ervien v.**

United States, 251 U.S. 41, 40 S. Ct. 75, 64 L. Ed. 128 (1919). This case involved an act passed by the Legislature in 1915 which allowed the Commissioner of Public Lands to use a certain amount of the income from sales and leases of lands "for making known the resources and advantages of this state generally and particularly to home-seekers and investors." The United States Attorney brought suit to prevent use of the money in this fashion on the ground that such a use of the funds would be a breach of the obligations assumed by the state at the time the lands were granted to it by the United States.

The United States District Court for New Mexico upheld the use of the funds for this purpose. However, the Circuit Court of Appeals reversed the lower court. **United States v. Ervien,** 246 F. 277 (8th Cir. 1917). By so doing it stated at 246 F. 279-280:

We think it is clear that the contemplated use of the funds would be a breach of the trust. Words more clearly designed than those of the act of Congress to create definite and specific trusts and to make them in all respects separate and independent of each other could hardly have been chosen. Each quantity of land with its proceeds was to be devoted to a particular object to the exclusion of all others. The act required 'separate funds' and provided that:

No monies shall ever be taken from one fund for deposit in any other or for any object other than that for which the land producing the same was granted or confirmed.

If there had been a single donation in trust for one of the purposes specified, as, for example, 'a miners' hospital for disabled miners,' it could not reasonably be contended that the trust funds could properly be expended in advertising the agricultural resources of the state or to promote the general welfare . . . That there were a number of trust donations for separately defined purposes does not alter the situation. The idea of a hotch-potch and a ratable contribution to a common object such as characterizes the proposed use was expressly negatived.

The United States Supreme Court affirmed the language and decision of the Circuit Court of Appeals in the **Ervien** case. The courts of New Mexico have been consistent in their adherence to this decision by the United States Supreme Court. **State v. Walker,** 61 N.M. 374, 301 P.2d 317 (1956); **State v. Mechem,** 56 N.M. 762, 250 P.2d 897 (1952); **State v. Ulibarri,** 34 N.M. 184, 279 P. 509 (1929); **Lake Arthur Drainage Dist. v. Field,** 27 N.M. 183, 199 P. 112 (1921).

The most recent case which has been decided on the question of permanent funds being used to benefit indirectly non-specified purposes is the case of **Lassen v. Arizona,** 385 U.S. 458, 87 S. Ct. 584, 17 L. Ed. 2d 515 (1967). The State of Arizona sued the Arizona Land Commissioner to prohibit him from requiring Arizona to pay the appraised value of the interests in "trust lands" which it received in the form of rights-of-way and material sites. The Arizona Supreme Court ordered the land commissioner to grant the interests in land to the state without requiring compensation. The United

States Supreme Court granted certiorari and reversed the decision of the Arizona Supreme Court.

Justice Harlan wrote the opinion for a unanimous court, stating at 385 U.S. 466, that "the Enabling Act unequivocally demands both that the trust receive the full value of any lands transferred from it and that any funds received be employed only for the purposes for which the land was given." Discussing the requirements and applicability of the Enabling Act at 385 U.S. 467, the Court stated:

Second, it imposes a series of careful restrictions upon the use of trust funds. As this Court has noted, the Act contains 'a specific enumeration of the purposes for which the lands were granted and the enumeration *{*165}* is necessarily exclusive of any other purpose.' Ervien v. United States, 251 U.S. 41, 47. The Act thus specifically forbids the use of 'money or thing of value directly or indirectly derived' from trust lands for any purposes other than those for which that parcel of land was granted . . . All these restrictions in combination indicate Congress' concern both that the grants provide the most substantial support possible to the beneficiaries and that only those beneficiaries profit from the trust.

Based upon this analysis of the Enabling Act provisions and the court cases interpreting them, several conclusions may be drawn concerning the New Mexico state permanent funds. First, any change, statutory or constitutional, in the provisions of the Enabling Act can occur only with the consent of the United States Congress. Second, the Enabling Act prescribes specific purposes for which the "trust lands" and their proceeds may be used. Third, state and federal courts have interceded numerous times to guarantee that the "trust funds" were used exclusively for these purposes and were not diverted to serve, even indirectly, a purpose other than that for which they were granted.

PART II: LAWS 1970, CHAPTER 2 AND THE PRUDENT MAN RULE

Section 11-2-10.2, N.M.S.A., 1953 Comp. (1970 Interim Supp.) provides:

The state investment officer, under the supervision of the state investment council, though not required to, may invest not more than twenty per cent [20%] of the permanent school fund and other permanent funds in interest-bearing time deposits at rates not lower than rates received by the state treasurer on deposits of public money. Deposits shall be secured as provided by law for securing deposits of public funds. **When determined to be in the best interests of the beneficiaries of the fund,** deposits shall be made in banks or savings and loan associations that are:

A. located in New Mexico;

B. approved by the state treasurer, commissioner of banking and the director of the department of finance and administration; and

C. provided that not more than five per cent [5%] of the permanent funds available for deposit under this section shall be deposited in any single savings and loan association or bank. (Emphasis added.)

The purpose of this act is set forth in Section 11-2-10.1, N.M.S.A., 1953 Comp. (1970 Interim Supp.), as to authorize the State Investment Officer to invest permanent funds in interest-bearing time deposits.

This act had a rather lengthy legislative history. Originally, the purpose of the legislation was to authorize the state investment officer to invest permanent funds in interest-bearing time deposits to promote the general welfare and economic growth of this state by making capital available for investment in communities in the state. In light of the above discussion relating to the purposes for which the permanent funds may be invested, this purpose would have run afoul of the mandates of the Enabling Act, **supra.** The Legislature omitted this statement of purpose, arriving at the purpose stated in Section 11-2-10.1, **supra.**

The final legislative product, S.B. 182, 29th Legis., 1st Ses. (1969), was vetoed by the Governor on April 5, 1969. The next session of the Legislature overrode his veto on February 2, 1970, with the legislation becoming N.M. Laws 1970, ch. 2, and codified as Sections 11-2-10.1 and 11-2-10.2, **supra.**

This legislation enables the State Investment Council to invest in interest-bearing time deposits issued by banks and savings and loan associations, provided, however, that the investment complies with the mandates of the Enabling Act, **supra,** and is indeed in the best interests of the beneficiaries of the funds.

When making investments of the state permanent funds, the State Investment Officer and the State Investment Council are bound to the standard of the prudent man rule of investments. Section 11-2-8.13, N.M.S.A., 1953 Comp., provides:

*{*166}* Investments made pursuant to this act shall be made with the exercise of that degree of judgment and care, under circumstances than prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering **the probable safety** of their capital as well as **the probable income** to be derived. (Emphasis added.)

This statutory language is very similar to the constitutional standard of prudence. N.M. Const. Art. 12, **§** 7. These standards are consistent with the intent of Congress that the funds provide the most substantial support possible to the beneficiaries and that only those beneficiaries profit from the trusts. **Lassen v. Arizona, supra,** 385 U.S. at 467.

Considering this standard, the probable income to be derived from the investment is crucial to a determination of whether the investment is prudent and is, therefore, legally permissible. Assuming that the probable safety of each investment proposal is comparable, if the probable income to be derived from interest-bearing time deposits is

less than the probable income that might be derived elsewhere, as is the case posed by the second question, it seems apparent that the investment does not comply with the standard of prudence and is, therefore, not a valid form of investment of the funds.

If the State Investment Council does invest state permanent funds in interest-bearing time deposits with a resulting loss of probable income from what it might have been had the funds been invested in investments yielding a higher rate of interest, the use of the funds would be a breach of trust, contrary to the Enabling Act, Section 10. To invest the funds in this manner would not be in the best interest of the beneficiaries and would subject the State Investment Council to prosecution by the Attorney General of the United States for breach of trust, pursuant to the Enabling Act, Section 10.

Investment of the state permanent funds in interest-bearing time deposits would be evidenced by certificates of deposit issued by the banks or savings and loan associations. A certificate of deposit is a written acknowledgement by the financial institution of the receipt of a sum of money on deposit which the financial institution promises to pay to the depositor. **Dollar Building & Loan Ass'n v. Shields,** 93 Colo. 480, 27 P.2d 485 (1933). Properly endorsed, a certificate of deposit is generally regarded as a negotiable instrument. **Reese v. First Nat'l Bank,** 196 S.W.2d 48 (Tex. Civ. App. 1946, ref'd N.R.E.). With the exception of its negotiable character, there is no distinction between a certificate of deposit and an ordinary deposit created in a pass book of the financial institution. **Bank of Commerce v. Harrison,** 11 N.M. 50, 66 P. 460 (1901). The basic principles that govern other types of deposits in financial institutions apply to certificates of deposit. **In re Elliott's Estate,** 378 Pa. 495, 106 A.2d 453 (1954).

The Federal Deposit Insurance Corporation insures certificates of deposit not to exceed ten thousand dollars for each depositor in each bank covered by the F.D.I.C. 12 U.S.C. **§** 1811. The Federal Savings and Loan Insurance Corporation insures certificates of deposit issued by savings and loan associations in the same manner as the F.D.I.C. does with bank deposits. 12 U.S.C. **§** 1725. To the extent that the certificates of deposit are so insured by the federal government, they are obligations guaranteed by the United States and are, therefore, to be considered non-corporate investments within the contemplation of Section 11-2-8(A), N.M.S.A., 1953 Comp. Opinion of the Attorney General No. 62-76, issued June 26, 1962. Compare **Federal Deposit Insurance Corp. v. Winton,** 131 F.2d 780 (6th Cir. 1942).

A national bank is a private corporation created and regulated by federal law. **Branch v. United States,** 100 U.S. 673, 25 L. Ed. 759 (1879). State banks are required to incorporate under the provisions of the Banking Act (Sections 48-22-1 to 48-22-73, N.M.S.A., 1953 Comp.). Section 48-22-42, **supra.** Federal savings and loan associations are corporations created by the Home Owners Loan Act of 1933. Act of June 13, 1933, 48 Stat. 128, 12 U.S.C. **§** 1461. State savings and loan associations are required *{*167}* to incorporate under the provisions of the Savings and Loan Act (Sections 48-15-45 to 48-15-142, N.M.S.A., 1953 Comp. [1969 Supp.]). Section 48-15-77, **supra.**

Even though financial institutions established and regulated by federal law have long been considered instrumentalities of the federal government, **McCulloch v. Maryland,** 17 U.S. (4 Wheat.) 316, 4 L. Ed. 579 (1819), the mere fact that such institutions might issue certificates of deposit does not elevate such securities to the status of obligations guaranteed by the United States unless such securities are insured by the F.D.I.C. or F.S.L.I.C. **F.D.I.C. v. Winton, supra.** Accordingly, the amount of such securities not so insured must be viewed, for purposes of investment by the State Investment Council, as corporate investments.

The State Investment Council may invest no more than fifty percent of the state permanent funds in corporate securities. N.M. Const. Art. 12, **§** 7. See also Section 11-2-8.12(E), N.M.S.A., 1953 Comp., for additional qualifications imposed upon the State Investment Council in investing in certain types of corporate securities. The State Investment Council must adhere to these restrictions in investing in interest-bearing time deposits issued by banks and savings and loan associations.

PART III: CONSTITUTIONAL POWER OF INVESTMENT OF STATE PERMANENT FUNDS

The New Mexico Constitution, Article 12, Section 7, provides that investment of the state permanent funds shall be done by the State Investment Officer under the supervision of the State Investment Council. It further provides that the Legislature may provide for the investment of the state permanent funds in "interest-bearing and other securities." This constitutional provision contemplates that the State Investment Council will establish "policy regulations" to govern the investment of state permanent funds and visualizes the independent exercise of delegated sovereign power by the State Investment Officer and the State Investment Council. Opinion of the Attorney General No. 58-10, issued January 10, 1958.

The determination of whether investment of the state permanent funds in interest-bearing time deposits will be in the best interest of the beneficiaries of the funds must be made by the State Investment Officer, under the supervision of the State Investment Council. Section 11-2-10.2, **supra.** After this initial determination is made, the Legislature requires that the funds shall be deposited only in banks or savings and loan associations that are "approved by the state treasurer, commissioner of banking and the director of the department of finance and administration." Section 11-2-10.2(B), **supra.** The state treasurer is a member of the State Investment Council. Section 11-2-8.5(B), N.M.S.A., 1953 Comp. The commissioner of banking is not such a member. Section 11-2-8.5, **supra.** The director of the department of finance and administration, although a member of the State Investment Council, may vote in the Council only in case of a tie. Section 11-2-8.5(D), N.M.S.A., 1953 Comp.

The ultimate determination of the investment of the state permanent funds in interest-bearing time deposits, under Section 11-2-10.2, **supra,** rests with those officers who approve banks or savings and loan associations for deposits of the funds. Unless the state treasurer, the commissioner of banking, and the director of the department of

finance and administration approve banks or savings and loan associations for deposit of the funds, the State Investment Officer is prevented from making such an investment even though the determination that such an investment will be in the best interest of the beneficiaries of the funds has already been made. Therefore, the Legislature effectively has provided that the investment of the state permanent funds may be regulated by someone other than the State Investment Officer or the State Investment Council.

Where the New Mexico Constitution has said that the State Investment Officer acting with the State Investment Council has the power and is charged with the duty to invest the state permanent funds (N.M. Const. Art. 12, **§** 7), the Constitution is the controlling and fundamental law as to that matter. **In re Atchison, T. & S.F. Ry.,** 37 N.M. 194, 20 P.2d 918 (1933). The Legislature must proceed in accordance *{*168}* with the terms of the Constitution, and no act of the Legislature can exercise or abridge the power to invest the state permanent funds or place the power elsewhere other than in the State Investment Officer and the State Investment Council. **In re Atchison, T. & S.F. Ry., supra.**

It follows, therefore, that Section 11-2-10.2, **supra,** insofar as it purports to provide that officers who are not the State Investment Officer or the State Investment Council must make the final determination of the investment of the state permanent funds in interest-bearing time deposits, offends the constitutional grant to the State Investment Officer and the State Investment Council of the power to invest the permanent funds. **In re Atchison, T. & S.F. Ry., supra.** To the extent that this provision is inconsistent with the Constitution, the provisions may well be found to be unconstitutional.

The next question obviously is whether or not the unconstitutional provision of Section 11-2-10.2 may be severed, leaving intact the remainder of the statute. The legislation, Laws 1970, Chapter 2, contained no savings clause providing that if a portion were declared unconstitutional the balance would remain intact. Consequently, there is no presumption in favor of severability and the courts would have to look to general principles of severability. Compare, **Romero v. Tilton,** 78 N.M. 696, 437 P.2d 157 (Ct. App. 1967), cert. denied, 78 N.M. 704, 437 P.2d 165 (1968).

Construing the 1970 statute as a whole it is arguable that the Legislature authorized the new investment on the condition that certain checks and balances would be created. That is particularly clear if one considers that investments with banks would be made only if the Commissioner of Banking gave his approval as to the soundness of the bank. Furthermore, if the Legislature entertained the same doubts about the prudence and constitutionality of the investments as are expressed above, then it is clear that the checks and balances provided by subparagraph B. would be necessary to give some protection to the permanent fund.

In view of this arguable intent of the legislation, when considered as a whole, it is not "plainly apparent that the Legislature would have enacted the valid portions of the act, even though it had then been known that the portion herein held invalid could not be carried into effect . . ." **Asplund v. Alarid,** 29 N.M. 129, 219 P. 786 (1923). Under the

general rule, portions of a statute may be severable "unless the parts sound and unsound are so mutually related, so blended together, as to constitute an entirety, making it evident that unless the act be carried into effect as a whole, it could not have received the legislative sanction." **State v. Brooken,** 19 N.M. 404, 143 P. 479 (1914).

In conclusion, there are serious doubts about the constitutionality of Laws 1970, Chapter 2 (Section 11-2-10.2, supra) in its entirety. Of course, it is the policy of this office to leave the final resolution of such a serious question to the judiciary. See Opinion of the Attorney General No. 69-75, issued July 14, 1969. **cf. State ex rel. Maloney v. Sierra,** No. 8964, N.M. Sup. Ct., November 23, 1970.

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