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IN THE WATER COURT OF THE STATE OF MONTANA
UPPER MISSOURI DIVISION
JEFFERSON RIVER BASIN (41G)

* * * * * * * * * * * * * * * * * * * *

IN THE MATTER OF THE ADJUDICATION OF THE EXISTING RIGHTS TO THE USE OF ALL THE WATER, BOTH SURFACE AND UNDERGROUND, WITHIN THE JEFFERSON RIVER DRAINAGE AREA, INCLUDING ALL TRIBUTARIES OF THE JEFFERSON RIVER IN BROADWATER, GALLATIN, MADISON, JEFFERSON AND SILVER BOW COUNTIES, MONTANA.	**CASE 41G-3** 41G-W-004096-00

CLAIMANT: Huckaba Ranch, Inc.

OBJECTOR: Golden Sunlight Mines, Inc.

OPINION

Procedural Background

Jessie S. Felsheim timely filed stockwater claim 41G-W-004096-00 for 3.5 acre-feet (30 gpm) of water from Sheep Rock Spring, diverted in the SESE of Section 17, T02N, R03W, Jefferson County for the use of 206 head of livestock in Sections 17, 20, 21, 22, 28 and 33, T02N, R03W. The claim is based on a claimed first use of the water by George T. Elliott and Grace C. Elliott in 1947.

Transfer documents filed with the Department of Natural Resources and Conservation (DNRC) indicate that the claim was subsequently transferred to Huckaba Ranch, Inc. ("Huckaba Ranch" or "Claimant").

Golden Sunlight Mines, Inc. ("Golden Sunlight" or "Objector"), timely filed an objection to the "ownership" of the claim, stating that:

> This objection is made for the reason that, pursuant to the Montana Supreme Court's decision in *Department of State Lands v. Pettibone* this water right, developed on lands that belonged to the State at the time the right came into being, was owned by the State rather than its lessee, Jesse Felsheim, who developed the right. This land was subsequently transferred to objector, in a land exchange, and the right therefore currently vests in Golden Sunlight Mines, Inc.

Water Master Michael J. L. Cusick held an evidentiary hearing. Following the hearing, the Master granted the Claimant's request to take judicial notice of certified copies of recorded deeds establishing the chain of title from the United States to Wiley Mountjoy, the Claimant's predecessor in interest.

The Water Master issued a Master's Report ultimately finding and concluding that:

> 17. The evidence at the hearing established that there is a long and continuous history of water use from Section 17 for cattle grazing on nearby sections of private property, more specifically, Sections 22, 28 and 33, and also adjacent sections of state land (now owned by Golden Sunlight Mines). The record establishes that ranchers grazing cattle in Sections 17, 20, 21, 22, 28 and 33 historically watered their cattle from the spring in Section 17. Witnesses from the Golden Sunlight Mine also testified that the water from Sheep Rock Spring has been put to beneficial use almost exclusively by the local cattle ranchers, i.e., Huckaba Ranch and its predecessors.
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> . . . .
>
> III. [I]t is clear from the record and the applicable law that the existing water right to Sheep Rock Spring with a priority date of December 31, 1947 claimed by Jesse Felsheim has at all times since that date remained appurtenant to the immediate vicinity of the spring location in section 17. This land, formerly owned by the State, is now owned by Golden Sunlight Mines. As such, claimant Jesse Felsheim had no existing right to the use of the water of Sheep Rock Spring, and therefore had no rights in Sheep Rock Spring that could be transferred to Huckaba Ranch, Inc. Furthermore, because the water right claimed by Felsheim is appurtenant to section 17, the objector Golden Sunlight Mines is the actual owner of the 1947 water right rather than Felsheim's successor, Huckaba Ranch, Inc.

(Master's Report and Mem. at 8-10).

In summary, the Master made the following points or conclusions in his Memorandum:

1. The land on which Sheep Rock Spring is located was *not* originally withdrawn from the public domain by the Organic Act and granted to the State of Montana specifically for the support of the common schools. Therefore, the school trust land rules articulated and applied by the Montana Supreme Court in *Dep't of State Lands v. Pettibone* are not applicable to this case. (Master's Report and Mem. at 13).

2. "Although [the land in Section 17] was not school trust land set aside by the Organic act, it was nevertheless . . . leased State land as opposed to . . . the public domain [and] water rights perfected on state lands by a lessee or sublessee, regardless of school trust status . . . becom[e] appurtenant to the land, inuring to the benefit of the lessor, in this case the State, and absent a specific severance, remains appurtenant, following title." (Master's Report and Mem. at 16-17).

3. "Generally, when water originates on state land, but is put to beneficial use on private property, the use of the water appurtenant to the private property is owned by the private landowner, not the State of Montana. Where water from State land is appurtenant to *both* private property and state property, the water right from the single source is split between the private landowner and the State. Furthermore, where a stockwater right consists of a man-made diversion (such as the post-1973 pipeline and stockwater tank development in this case) the corresponding water right can become appurtenant to outlying sections of land where that water is delivered and consumed by the cattle. Combining these principles, a stockwater system located on *both* state and private land (such as the one installed by Jesse Felsheim) would be appurtenant to *both* and would be split according to the location of and amount of water used at each tank or trough." (Master's Report and Mem. at 17-18) (emphasis added).

4. Where, as here, however, the livestock drink directly from the source, and there is no manmade diversion and distribution system conveying the water to nonriparian land for consumption by the livestock, the place of use is identical to the point of diversion, i.e, the undeveloped spring itself, and the corresponding water right becomes appurtenant only to the immediate vicinity of the undeveloped spring. (Master's Report and Mem. at 18-19).

Huckaba Ranch objected to the Master's Report and asked the Water Court to reverse the Master's conclusion with respect to ownership, based primarily on its assertion that:

> (1) Water appropriated by cattle drinking at specific water sources is appurtenant to 'that portion of the public range available to livestock watering at such places;' and
>
> (2) the Master's refusal to find that water from Sheep Rock Spring is appurtenant to Section 22, absent a 'diversion and conveyance system,' is contrary to fundamental principles of water law.

Following timely responses and replies, the parties deferred to the Court's discretion with respect to oral argument, thereby waiving their right to a hearing under Rule 53, M.R.Civ.P.

Standard of Review

Rule 53(e)(2), M.R.Civ.P., requires the Court to accept a Master's Findings of Fact unless clearly erroneous. To determine whether a Master's findings are clearly erroneous, the Water Court uses a test similar to the three-part test employed by the Montana Supreme Court in *Interstate Prod. Credit Ass'n v. DeSaye* (1991), 250 Mont. 320, 323, 820 P.2d 1285, 1287. First, the record will be reviewed to see if the findings are supported by substantial evidence. Substantial evidence is more than a scintilla, but less than a preponderance of evidence. *State v. Shodair Hosp.* (1995), 273 Mont. 155, 163, 902 P.2d 21, 26. It is evidence which a reasonable mind might accept as adequate to support a conclusion, even if the evidence is weak or conflicting. *Arnold v. Boise Cascade Corp.* (1993), 259 Mont. 259, 265, 856 P.2d 217, 220.

Secondly, if the findings are supported by substantial evidence, the Court will determine whether the Master misapprehended the effect of evidence. Finally, if substantial evidence exists and the effect of evidence has not been misapprehended, the Court may still decide that a finding is clearly erroneous if, although there is evidence to support it, a review of the record leaves the Court with the definite and firm conviction that a mistake has been committed. *Interstate Prod. Credit Ass'n*, 250 Mont. at 323.

The Water Court reviews conclusions of law to determine whether they are correct. *Geil v. Missoula Irrigation Dist.*, 2002 MT 269, ¶ 22, 312 Mont. 320, ¶ 22, 59 P.3d 398, ¶ 22; *Steer, Inc. v. Dep't of Revenue* (1990), 245 Mont. 470, 474-75, 803 P.2d 601, 603. The Water Court reviews discretionary rulings for an abuse of discretion. *Harwood v. Glacier Elect. Coop., Inc.* (1997), 285 Mont. 481, 492, 949 P.2d 651, 658.

Statement of the Issues

The Claimant did not object to any of the Master's factual findings, and substantial evidence supports all of the Master's Findings of Fact. Therefore, there are no material issues of fact in this case. The primary legal issue before the Court is:

> Who owns a direct stockwater right appropriated and perfected on lands acquired by the State with funds from the State Public School Permanent Fund? Implicit in that issue are the following legal issues raised by the parties and the evidence:
>
> A. Whether the land on which Sheep Rock Spring is located was subject to the public school trust when the Elliotts' livestock directly used Sheep Rock Spring water in 1947?
>
> B. Whether the Elliots' direct use of Sheep Rock Spring water in 1947 for the benefit of their livestock created a water right in the Elliotts' name which then became appurtenant to their private grazing land in Section 22?

This opinion is the third in a series of decisions recently issued involving public land and livestock issues. *See* Opinion, Order Amending and Adopting Master's Report, Water Court Case 40E-A (June 29, 2005); and Opinion, Order, Water Court Case 41G-190 (July 19, 2005).

Discussion

Who owns a direct stockwater right appropriated and perfected on lands acquired by the State with funds from the State Public School Permanent Fund?

Ownership of Water Rights Appropriated on Public Domain

Prior to 1973, a water right appropriated in accordance with Montana law or custom generally vested in the appropriator. *Osnes Livestock Co. v. Warren* (1936), 103 Mont. 284,

290, 62 P.2d 206; *St. Onge v. Blakely* (1926), 76 Mont. 1, 18, 245 P. 532, 537; *Smith v. Denniff* (1900), 24 Mont. 20, 27, 60 P. 398, 400. "When the right was fully perfected, that is, when there was a diversion of the water and its application to a beneficial use, it thereupon became a property right of which the owner could only be divested in some legal manner." *Osnes Livestock Co.*, 103 Mont. at 294. *See also Smith*, 24 Mont. at 27 (stating that a water right is "a positive, certain, and vested property right" of which the appropriator could not be divested).

Once perfected, the water right included "an incorporeal hereditament . . . the right to have the water flow in the stream, without diminution or deterioration, to the head of the ditch or place of diversion, – an easement in the stream . . . an easement not attached to land, and therefore *akin to an easement in gross* at the common law," which may or may not become an easement annexed or attached to particular land. *Smith*, 24 Mont. at 25, 27 (emphasis added).

The statutory rule in Montana is that, "[a] thing is deemed to be incidental or appurtenant to land when it is by right used with the land for its benefit."[1] However, whether a water right becomes appurtenant to and transfers with particular land in Montana are matters of intent and questions of fact and the one asserting ownership by appurtenancy has the burden of proving that it is appurtenant. *Smith*, 24 Mont. at 29. *See also* 1 Wells A. Hutchins, *Water Rights Laws in the Nineteen Western States*, at 458-59 (1971).

Generally, a water right does not become an appurtenance to land titled in another, until: (1) the appropriator obtains title to the land; (2) the water right is conveyed to the owner of the land, or (3) the facts and circumstances indicate that the appropriator intended to make the right appurtenant to the land.[2]

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[1] Section 70-15-105, MCA (initially enacted as §1078 Civ. C. Mont. (1895)). *See e.g., Castillo v. Kunnemann* (1982), 197 Mont. 190, 201-02, 642 P.2d 1019.

[2] *See* Opinion, Order Amending and Adopting Master's Report, Water Court Case 41G-190 (July 19, 2005), for a more complete discussion of this issue.

Department of State Lands v. Pettibone

In *Department of State Lands v. Pettibone* (1985), 216 Mont. 274, 702 P.2d 948, the Montana Supreme Court created a narrow, but clear exception to these general rules of ownership and appurtenancy in Montana, when it held that the State of Montana owned water rights appropriated by lessees on and for use on school trust land. In doing so, the Supreme Court reversed the Montana Water Court's contrary decision issued in the Powder River Drainage Area.

In the Final Decree for the Powder River Drainage Area (Basins 42I and 42J), issued April 14, 1983, the Montana Water Court found and concluded that water rights appropriated by lessees on and for use on school trust lands vested in the appropriator/lessee, not the State of Montana. The State of Montana appealed the Water Court's decree of twenty-three rights that were diverted or developed on and for school trust land in the drainage area. Those water rights generally fell into the following categories:

> Groundwater Wells: Four rights from groundwater wells, three of which were on school trust lands and used wholly thereon, and one which straddled the border between a state-owned and privately-owned section and was used on both.
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> Developed Springs: Three rights were in developed springs for stockwater, which were situated and used on school trust land.
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> Diversions of Tributaries: Fifteen rights arose from diversions from tributaries, with thirteen rights diverted and used wholly on school trust land, one right diverted from a stock reservoir located on both school trust land and adjacent private land and used on both, one right diverted on school trust land for irrigation on both state and private land.
>
> Direct Use: One right was a direct stockwater appropriation from an undeveloped spring located and used entirely on school trust land.

Pettibone, 216 Mont. at 365.

The *Pettibone* Court based its decision on school trust land principles previously articulated and applied in *Lassen v. Arizona* (1967), 385 U.S. 458, 87 S. Ct. 584; *Trustees of Vincennes University v. State of Indiana* (1852), 55 U.S. 268, 14 L. Ed. 416, 14 How. 268;

Jerke v. State Dep't of Lands (1979), 182 Mont. 294, 597 P.2d 49; *Rider v. Cooney* (1933), 94 Mont. 295, 23 P.2d 261; *Skamania County v. Washington* (Wash. 1984), 685 P.2d 576.

The *Pettibone* Court concluded that "[t]he essence of a finding that property is held in trust, school, public, or otherwise, is that anyone who acquires interests in such property does so subject to the trust." *Pettibone*, 216 Mont. at 375. The Montana Supreme Court noted that "[t]he courts have been very protective of the trust concept and emphatic about the need to preserve the value of the trust corpus -- the school lands." *Pettibone*, 216 Mont. at 369. It cited United States Supreme Court caselaw for three important principles governing the school trusts: (1) trusts created by the enabling acts are similar to private charitable trusts; (2) the enabling acts creating school trusts must be strictly construed according to fiduciary principles; and (3) enabling acts, in general, preempt state law and constitutions. *Pettibone*, 216 Mont. at 369 (citing *Andrus v. Utah* (1980), 446 U.S. 500, 520, 523, 100 S. Ct. 1803, 1814, 1815, 642 L. Ed. 2d 458, 472, 474; *Springfield Township v. Quick* (1859), 63 U.S. 56, 16 L. Ed. 256; *Trustees of Vincennes University*, 55 U.S. 268).

Based on those principles, the Court formulated two rules that must be applied when considering private water rights appropriated and perfected on school trust land in Montana:

> *First*, an interest in school land cannot be alienated unless the trust receives adequate compensation for that interest. Water that is appurtenant to the school lands is an interest for which the trust must receive compensation. *Second*, any law or policy that infringes on the state's managerial prerogatives over the school lands cannot be tolerated if it reduces the value of the land.

Pettibone, 216 Mont. at 371 (emphasis added).

In applying the first rule, the Court found that a special relationship exists between the lessees of school trust lands and the State of Montana:

> The lessee, in making appropriations on and for school trust sections, is acting on behalf of the State. . . . The lessee, under the terms of the lease, is simply entitled to the use of water appurtenant to the school trust land. *The State is the beneficial user of the water, and its duty as trustee of the school trust lands prohibits it from alienating any interest in the land, such as the appurtenant water right, without receiving full compensation therefore.*

Pettibone, 216 Mont. at 368. (emphasis added). Absent such full compensation, "the water right remains appurtenant, following title [in the State]. It does not make sense for each

succeeding tenant to walk off with one water right after another." *Pettibone*, 216 Mont. at 372. This rule applies to all ground and surface water rights that are "appropriated and used on" school trust land. *Pettibone*, 216 Mont. at 376.

As an alternative ground for its decision, the *Pettibone* Court applied the second rule and found that vesting title to *appurtenant* water rights in lessees would violate the trust for another reason: It would infringe on the use or management prerogatives of the State over the school trust land and effectively devalue the land. "This situation is clearly repugnant to school trust principles." *Pettibone*, 216 Mont. at 373.

A.

Whether the land on which Sheep Rock Spring is located was subject to the public school trust when the Elliotts' livestock first used the water in 1947?

The State Common School Permanent Fund acquired the land in Section 17 on which Sheep Rock Spring is located, as Mortgagee, by quit claim deed in lieu of foreclosure in 1924. Although Section 17 was not one of the original sections designated and granted to the State of Montana for the support of the common schools under the Act of February 22, 1889 ("the Enabling Act"), ch. 180, 25 Stat. 676 (1889), the State acquired it with funds from the common school permanent fund. Such funds form part of the corpus of the trust for the support of common schools. *State ex rel. Galen v. District Court* (1910), 42 Mont. 105, 114, 112 P. 706, 707.

Section 10 of the Enabling Act, provides in part that: "Upon the admission of each of said states into the Union, sections numbered sixteen and thirty-six in every township . . . are hereby granted to said states *for the support of common schools*." (emphasis added). In 1924, Section 11 of the Enabling Act provided:

> That *all lands herein granted for educational purposes* shall be disposed of only at public sale, and at a price not less than ten dollars per acre, *the proceeds to constitute a permanent school fund, the interest of which only shall be expended in the support of said schools*. But said lands may, under such regulations as the legislatures shall prescribe, be leased for periods of not more than five years, in quantifies not exceeding one section to any one person or company; and such lands shall not be subject to pre-emption, homestead

entry or any other entry under the lands laws of the United States, whether surveyed or unsurveyed, but shall be reserved for school purposes only.

(Emphasis added)[3]

Section 1 of Article XVII of the Montana Constitution (1889) declared that:

> All lands of the state that have been, or that may hereafter be granted to the state by congress, *and all lands acquired by gift or grant or devise*, from any person or corporation, shall be public lands of the state, and shall be *held in trust* for the people, to be disposed of as hereafter provided, *for the respective purposes for which they have been or may be granted, donated or devised . . .*

Mont. Const. Art. XVII, § 1 (1889) (emphasis added).

Section 2, Article XI of the Montana Constitution (1889) defined the public school fund to consist of "*the proceeds of such lands* as have heretofore been granted, or may hereafter be granted, to the state by the general government known as school lands; . . . *and all other grants*, gifts, devises or bequests made *to the state for general educational purposes*." *Id.* at § 2 (emphasis added). Section 3 of the same Article provided that, "[s]uch public school fund *shall forever remain inviolate, guaranteed by the state against loss or diversion*, to be invested, so far as possible, in public securities within the state, including school district bonds, issued for the erection of school buildings, under the restrictions to be provided by law." *Id.* at §3 (emphasis added).

Based on these declarations, the Montana Supreme Court has repeatedly held that both *the lands* granted to the State of Montana for the support of common schools, *as well as the fund created from the disposition of those lands*, constitutes a trust, the terms of which are set forth in the Montana Constitution and the Enabling Act, and the State of Montana is the trustee. *Montanans for the Responsible Use of School Trust v. State*, 1999 MT 263, ¶¶ 13-14, 296 Mont. 402, ¶¶ 13-14, 989 P.2d 800, ¶¶ 13-14; *Rider*, 94 Mont. at 306-07; *State ex rel. Galen v. District Court* (1910), 42 Mont. 105, 114, 112 P. 706, 707; *State ex rel. Koch v. Barret* (1901), 26 Mont. 62, 68-70, 66 P. 504, 507; *State ex rel. Bickford v. Cook* (1896), 17 Mont. 529, 535, 43 P. 928, 930.

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[3] Section 11 was subsequently amended by the Act of June 25, 1938, and accepted by the Montana Legislature by Chapter 8, Laws of 1939.

The Farm Loan Act

Neither the Organic Act of May 26, 1864, 13 Stat. 1864, nor the Enabling Act attempted to regulate the manner in which the permanent funds derived from the original grant lands could be invested. The Enabling Act, for example, merely restricted the use of such funds exclusively to the purposes set forth in the Act and "in such manner as the legislatures of the respective states may severally provide." *State ex rel. Evans v. Stewart* (1916), 53 Mont. 18, 22, 161 P. 309, 311-12. Nor did the Montana Constitution attempt to regulate the manner in which the permanent funds could be invested, except to declare that the common school permanent fund would "forever remain inviolate, guaranteed by the state against loss or diversion, to be invested as far as possible, in public securities within the state . . . under the restrictions to be provided by law." Mont. Const. art. XI, § 3 (1889).

In 1914, the people of Montana passed by initiative the Farm Loan Act. 1915 Mont. Laws 486. Section 1 of the Act provided that the common school permanent fund shall be invested by the state board of land commissioners in, among other things, first mortgages on good, improved farm lands of the State.

In 1916, the Montana Supreme Court determined that, with the exception of the "contingency plan" set forth in Sections 2, 9 and 12, the authorization to invest permanent school funds in farm mortgages by the Farm Loan Act did not violate either the Constitution or the Enabling Act. *Toole County Irrigation Dist.*, 104 Mont. at 432 (citing *Stewart*, 53 Mont. 18). In 1917, based on the 1916 *Stewart* opinion and at the urging of the Governor, the legislative assembly amended the Farm Loan Act to remove the unconstitutional provisions and more explicitly protect the common school permanent fund from diminution or loss. *Toole County Irrigation Dist.*, 104 Mont. at 433.

By the mid-1930s, the State of Montana had invested over $4,000,000 of the common school permanent fund on improved farm land pursuant to the Farm Loan Act. *Toole County Irrigation Dist.*, 104 Mont. at 437. As explained by the Court in *Toole County*:

> With the wisdom of those laws relating to farm loans from this fund we are not here concerned. The history of their enactment, as set forth elsewhere in this decision, clearly discloses that the people and the legislature went into the business of making farm loans with "eyes open." They knew of the sacred and inviolate character of the funds from which they were authorizing loans to be made.

Toole County Irrigation Dist., 104 Mont. at 437. Ultimately, many of the mortgagors defaulted on the loans, and the State was called upon to meet its fiduciary duty to guarantee the trust fund against loss or diversion. *Toole County Irrigation Dist.*, 104 Mont. at 437-38. As explained by the Court in *Toole County*:

> [T]he mandatory duty imposed by the Constitution upon the state to guarantee the fund against loss or diversion came squarely before them.
>
> Aware of its solemn trust, the Twenty-fourth Legislative Assembly in 1935 enacted legislation specifically recognizing the liability of the state and acknowledging its obligation to keep inviolate the public permanent school fund, and its guaranty to protect it against loss or diversion, *including loss from investments in state farm loans* . . . . Section 2 of that chapter . . . reads in part as follows: "The state itself hereby *assumes and takes over all of such farm mortgage loans* now existing as such, [*all the lands taken over by the state under such mortgages, through foreclosure proceedings and otherwise*, together with all the tenements, hereditaments, and appurtenances thereunto belonging;] . . . and *the state hereby promises and agrees to repay* to the public school permanent fund the said sum of four million two hundred fifty thousand six hundred twenty-five and 95/100 dollars ($4,250,625.95) [as of January 1, 1935, *together with interest on the balance remaining* from time to time unpaid] . . . from the proceeds of such farm mortgage loans and lands and from such other sources other than that the state general fund as the legislative assembly may provide."

Toole County Irrigation Dist., 104 Mont. at 437-38 (emphasis added) (bracketed language derived from ch. 250, § 1218.2, 1935 Mont. Laws).[4]

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[4] Based on this analysis, the *Toole* Court reaffirmed that "if a loan is made of the school funds upon farm lands, the lands are still subject to taxation, and the state of Montana is obliged to protect its loan by the payment of the taxes levied against the land," and "*while these loans were not made upon lands that were school lands at the time, the principle is the same.*" *Toole County Irrigation Dist.*, 104 Mont. at 439 (citing *State ex rel. Malott v. Board of County Commrs. of Cascade County* (1930), 89 Mont. 37, 93, 296 P. 1, 18) (emphasis added).

On March 23, 1953, the legislative assembly further amended Section 1218.2 of Chapter 250 to provide that:

> *In lieu of the repayment of this interest* [on the balance remaining], and as complete fulfillment of all claims upon the State of Montana by the state public school permanent fund as a result of the obligations incurred through chapter 124, laws of 1917, the State of Montana hereby *transfers to the state public school permanent fund all farm mortgage loans now existing as such, all the lands taken over by the state under such mortgages through foreclosure proceedings and otherwise, together with all tenements, hereditaments and appurtenances thereto belonging* . . . . The administration of these lands shall remain as outlined in sections 75-3730, 75-3731, 75-3732 and 75-3733, and the income from these lands shall be allocated in the same manner as the income from all other lands belonging to the state public school permanent fund."

Ch. 250, 1953 Mont. Laws 636-37 (emphasis added). This section was repealed by Chapter 5, Section 496, 1971 Session Laws, and replaced by Section 75-7302, RCM (1947), which succinctly provided:

> **75-7302. Title to farm mortgage lands vested in state and transfers validated.** The transfer of farm mortgage lands made by Chapter 250, Laws of 1953, shall be deemed to have vested title in such lands in the state of Montana in trust for the state public school fund.

The statute continues in the same form today, codified at § 20-9-602, MCA.

Based on this legislative history, it seems clear that even before the legislative enactments of 1953 and 1971, the State of Montana held title to the lands acquired through foreclosure of farm mortgage lands, or deeds in lieu of foreclosure, subject to the public school trust. The Montana Supreme Court has consistently characterized the original grant lands and the permanent fund derived from those lands, as a "sacred and inviolate" trust. Under general trust principles, the Montana Supreme Court has held that, "[a]ll property belonging to a trust, however much it may be changed or altered in its nature or character, and all the fruit of such property, whether in its original or its altered state, continues to be subject

to or affected by the trust." *State v. Banking Corp. of Mont.* (1926), 77 Mont. 134, 147, 251 P. 151 (citing 3 Pomeroy's Equity Jur. 2398 (4th ed.).

This general rule has been applied to real estate, in general, *Redfield v. Johnson* (Wash. 1930), 291 P. 1077, and to school trust lands, in particular. *Murphy v. State* (Ariz. 1947), 181 P.2d 336, 339.

In *Murphy v. State*, for example, the Arizona State Court concluded that:

> Even in the absence of the constitutional declaration (art. 10, sec. 1) that "all lands otherwise acquired by the state, shall be by the state accepted and held in trust to be disposed of in whole or in part, only in manner as in the said Enabling Act and in this constitution provided,"[5] we believe that under the general law of trusts the disposition of these lands acquired on foreclosure would be controlled by the trust agreement (Enabling Act). An applicable test statement is set forth in 54 Am. Jur., Trusts, sec. 251, as follows: "A trust follows property or funds into the proceeds or products of the same, . . ." In *Nelson v. Wood*, 199 Ark. 1019, 137 S.W. 2d 929, it was held that a trust follows a mortgage belonging to trust estate into land if mortgage is foreclosed.
>
> In the instant case we know that the lands traded were acquired by the proceeds of the original trust res. The following text statement is apropos: "Most American courts have recognized this elementary conception with regard to the remedy of tracing, and have insisted that the cestui or successor trustee who is seeking to follow trust funds should convince the court that the . . . *realty, or other property, which the complainant desires to take from the hands of a defaulting trustee or another not a bona fide purchaser, either is part or all of the original trust property, or is property which has been produced by the original trust res through sale, barter, reinvestment or some other process.*" "So long as the trust property can be traced and followed into other property into which it has been converted, it remains subject to the trust. *The product or substitute has the nature of the original imparted to it.*"
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> . . . .

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[5] This constitutional declaration is substantially similar to the Montana Constitution (1889), which declared that:

> All lands of the state that have been, or that may hereafter be granted to the state by congress, *and all lands acquired by gift or grant or devise*, from any person or corporation, shall be public lands of the state, and shall be *held in trust* for the people, to be disposed of as hereafter provided, *for the purposes for which they have been or may be granted, donated or devised*; and none of such land, nor any estate or interest therein, shall ever be disposed of except in pursuance of general laws providing for such disposition, nor unless the full market value of the estate or interest disposed of, to be ascertained in such manner as may be provided by law, be paid or safely secured to the state; . . .

Mont. Const. art. XVII, § 1 (1889) (emphasis added).

> **Applying these principles it is apparent that these lands acquired on foreclosure belonged to the trust estate and there was imparted to them all the characteristics of the original trust lands**. By the Enabling Act it is provided that: "Disposition of any of said lands, or of any money or thing of value directly or indirectly derived therefrom, for any object other than for such particular lands, or the lands from which such money or thing of value shall have been derived, were granted or confirmed, or in any manner contrary to the provisions of this Act, shall be deemed a breach of trust."[6]

Murphy, 181 P.2d at 353-54 (emphasis in the original) (bold added).

Applying the Montana Supreme Court's conclusion that the Public School Permanent Fund is part of the trust corpus for the support of the common (public) schools, the "sacred and inviolate" nature of that trust, the "taking over" of all farm mortgage loans and the lands securing those loans by the State in 1935 as part of "its solemn trust, and the trust pursuit rules of general trust law, it is apparent that when the Mountjoys quitclaimed their interest in Section 17 to the State of Montana in lieu of foreclosure of their state farm mortgage in 1924, or at least from the time of passage of Section 1218.1 of Chapter 127, Session Laws of 1935, the State of Montana held legal title to the land on which Sheep Rock Spring is located, subject to the public school trust. The legislative enactments of 1953 and 1971 merely clarified and made express what had previously been implicit in the law. As the *Pettibone* Court concluded, "the essence of a finding that property is held in trust, school, public, or otherwise, is that anyone who acquires interests in such property does so 'subject to the trust.'" *Pettibone*, 216 Mont. at 375. Accordingly, when the Elliotts first used water from Sheep Rock Spring in 1947 for the benefit of their livestock grazing on State land in Section 17, pursuant to the State grazing lease (sublease), they were acting on behalf of the State of Montana, and title to the water right vested in the State, for the support of the public schools.

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[6] In addition, Montana law has long recognized that a constructive trust arises when a person (in this case the State of Montana) holding title to property is subject to an equitable duty to convey it to another (in this case the Public School Permanent Fund) on the ground that the person holding title would be unjustly enriched if he were permitted to retain it." See § 72-33-219, MCA, which codified the principle as articulated and applied by the Montana Supreme Court since at least 1905. *See, e.g., Lutey v. Clark* (1904), 31 Mont. 45, 77 P. 305.

B.

Whether the Elliots' use of Sheep Rock Spring water in 1947 for the benefit of their livestock created a water right in the Elliotts' name which then became appurtenant to their private grazing land in Section 22?

The Master properly concluded that "the existing water right to Sheep Rock Spring with a priority date of December 31, 1947 claimed by Jesse Felsheim, has at all times since that date remained appurtenant to the immediate vicinity of the spring location in section 17." (Master's Report and Mem. at 9). This conclusion can be supported on two independent footings.

First, in *Pettibone*, the Montana Supreme Court concluded that "[s]ince an appurtenant water right is an interest in the land it cannot be surrendered by the State without the trust receiving fair market value." *Pettibone*, 216 Mont. at 373 (citations omitted). "The State has no power, absent adequate consideration, to grant the lessees the permission to develop non-appurtenant water rights, and every school trust lease carries with it this limitation." *Pettibone*, 216 Mont. at 375.

There has been no allegation or evidence in this case that the Claimant or its predecessors (including the Elliotts) ever paid any consideration to the State, apart from that required by the leases and the agreed-upon portion of the 1979-80 water distribution improvements. Absent such consideration, title to the water right remained in the State of Montana, as trustee of the land. As there is no evidence that it was ever severed from the land, it transferred with the land as an appurtenance to Golden Sunlight in 1985.

Second, the decision that claim 41G-W-004096-00 is appurtenant only to NWSWSE of Section 17 draws support from the "Cost-Share Agreement Stockwater Spring and Pipeline" signed by Jessie S. Felsheim on October 10, 1979 and the State on November 16, 1979. In that Agreement, the parties agreed as follows:

> THE STATE AGREES TO:
>
> . . . .
>
> 5. File for the water right with the Department of Natural Resources and Conservation and pay all necessary fees to obtain the water right.

6. Issue a Water Use Agreement to the Lessee, at the discretion of the Department, if the water is to be used off the State land.

THE LESSEE AGREES TO:

. . . .

5. Secure a Water Use Agreement from the Department of State Lands if any portion of the water is to be used off of State land at the terms established by the Department for such practices.

(Ex. GSM-5, at 1-2).

Attached to the Cost-Share Agreement is a map of the pipeline and stockwater development depicting a pipeline extending from Sheep Rock Spring across public and private lands to service stock tanks located on public and private lands. As indicated in paragraph 5 above, the parties agreed that the State was to obtain a water right to use Sheep Rock Spring water in this development. In accordance with that Agreement, the State obtained two Certificates of Water Right, both with 1981 priority dates. (Ex. GSM-2 & -3). Certificate of Water Right number 31297-G41G authorized the diversion of water from a developed spring at the NWSWSE of Section 17, Township 2 North, Range 3 West for use, in part, on the southeast and southwest of Section 17. Both certificates were subsequently transferred to Golden Sunlight Mine in 1985. (Ex. GSM-4)

By relying on and using the State's Certificates of Water Right to water livestock from 1982 to the present, the Claimant, and its predecessor in interest, would have effectively abandoned any 1947 claim to the water. *O'Shea v. Doty* (1923), 68 Mont. 316, 319-21, 218 P. 658, 659. *See also 79 Ranch v. Pitsch* (1984), 204 Mont. 426, 666 P.2d 712.

If the State's Certificates of Water Right from Sheep Rock Spring represent nothing more than a change in place of use of the 1947 Sheep Rock stock water claim, as suggested by witness Tom Hughes, testifying as a Department of State Land employee, (a position apparently adopted by the Claimant in its Proposed Finding of Fact 40 and Proposed Conclusion of Law 30), then the Cost-Share Agreement demonstrates the recognition of Jessie Felsheim in 1979 that any water diverted from Sheep Rock Spring for the use of her livestock was based upon a stockwater right that actually belonged to the State.

Conclusion

Substantial evidence supports the Master's Findings of Fact and the Master's numbered Conclusions of Law are not in error. Although the Master arrived at the correct decision, his determination that the rule in *Pettibone* was not applicable in this case was in error. *See* (Master's Report and Mem. at 13). Furthermore, his determination that stockwater rights can never become appurtenant to nonriparian lands was also in error. (Master's Report and Mem. at 17-20). Whether a water right becomes appurtenant to and transfers with particular land in Montana are matters of intent and questions of fact. *Smith*, 24 Mont. at 29. *See also* 1 Wells A. Hutchins, *Water Rights Laws in the Nineteen Western States*, at 458-59 (1971). Under the appropriate circumstances, a water right can become appurtenant to nonriparian lands. *See, e.g.,* Opinion, Order Amending and Adopting Master's Report, Water Court Case 41G-190 (July 19, 2005).

The Water Master was correct in determining that the ownership of stockwater claim 41G-W-004096-00 should be in the name of Golden Sunlight Mines, Inc. and not in the name of Huckaba Ranch, Inc. The Master was also correct in identifying the point of diversion and place of use as the NWSWSE of Section 17, Township 2 North, Range 3 West.

DATED this 3 day of August, 2005.

C. Bruce Loble
Chief Water Judge

CERTIFICATE OF SERVICE

I, Anna M. Burton, Clerk of Court of the Montana Water Court, hereby certify that a true and correct copy of the above **OPINION** was duly served upon the persons listed below by depositing the same, postage prepaid, in the United States mail.

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DATED this 3rd day of August, 2005.

Anna M. Burton
Clerk of Court