STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

A PERFORMANCE AUDIT
of

THE ARIZONA STATE LAND DEPARTMENT

AUGUST 1980

A REPORT TO THE
ARIZONA STATE LEGISLATURE

REPORT 80-3

DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

August 29, 1980

The Honorable Bruce Babbitt, Governor
Members of the Arizona Legislature
Mr. Joe T. Fallini, State Land Commissioner

Transmitted herewith is a report of the Auditor General, A Performance Audit of the State Land Department. This report is in response to the June 19, 1979, resolution of the Joint Legislative Budget Committee:

A summary of this report is found on the blue pages at the front of the report. A response to this report by the State Land Commissioner is found on the yellow pages preceding the appendices.

My staff and I will be happy to meet with appropriate legislative committees, individual legislators or other State officials to discuss or clarify any items in the report or to facilitate implementation of the recommendations.

Respectfully submitted,

Douglas R. Norton
Auditor General

Staff: Gerald A. Silva
Dwight A. Ochocki
Robert T. Back
Kirk J. Schneider
Blake P. Peterson

OFFICE OF THE AUDITOR GENERAL

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SUMMARY

In 1915, the Arizona Legislature created the State Land Department to "...administer all laws relating to lands owned by, belonging to, and under the control of the state."

Acting as trustee, the Department's primary responsibility is to manage Federal land granted to Arizona beneficiaries. In keeping with its fiduciary responsibility, the Department is expected to obtain fair market value for the lands and products of the land such as minerals, timber, oil and gas.

Our review of the State Land Department revealed that:

- Arizona has one of the lower mineral royalty fees among states that lease state lands for the extraction of metalliferous minerals. If Arizona's royalty rate for the extraction of metalliferous minerals from State lands were comparable to that of other states, revenues from mineral leases would have been as much as $6.5 million more during 1979.

- Arizona's net value method of assessing royalty fees requires more paperwork on the part of lessees, and auditing and review by the State Land Department, than would a gross value method for determining royalty rates.

- Current statutes are vague regarding the determination of mineral royalties and the timeliness of payment.

- The State Land Department has not established adequate rules and regulations regarding mineral royalties.

- The State Land Department has not reviewed or audited mineral royalties adequately.

- The State Land Department charges a grazing fee rate that is significantly lower than the rate charged by the Bureau of Land Management, nine other western states and private industry. If Arizona's grazing fee rate were comparable to that charged by other public and private entities, Arizona would receive from $703,000 to $5.2 million in additional revenues from grazing leases.

- The State Land Department has not been given specific statutory responsibility to identify and resolve instances of trespass on State lands nor has it been provided with adequate resources to do so. As a result, during 1979 at least $786,000 in damage was inflicted on State lands by trespassers and a related $2.3 million in compensation may be lost to the State.

It is recommended that:

- Arizona Revised Statutes (A.R.S.) §27-234(B) be amended to provide for:

  A greater return on State mineral royalties.

  Assessment of royalty fees on gross valuation rather than net valuation.

  Giving the State Land Department authority to establish royalty rates for mining leases that provide an equitable return on State lands and that allow for production or operational differences between lessees.

  More specificity regarding the price basis for calculating gross values and the timeliness of royalty payment.

  Penalty provisions for late payments.

- The State Land Department establish more definitive rules and regulations regarding mineral royalties and reporting procedures.

- The State Land Department acquire the expertise to review monthly mineral production reports adequately by contracting for professional services or hiring personnel who are knowledgeable in accounting and mining procedures, if the net valuation basis is retained in the statutes.

- A.R.S. §37-285(B) be amended to allow for a substantial increase in the annual rental rate charged for each animal feeding on State land. Consideration should be given to adoption of the Bureau of Land Management's grazing rate formula as established by the Congress of the United States in the Public Rangelands Improvement Act of 1978.

- The Arizona Revised Statutes be amended to require that the State Land Department identify and resolve instances of trespass on State lands.

- The Department be provided with staffing and resources commensurate with that additional responsibility.

- The Department develop and adopt formal procedures to review, investigate and monitor trespass activity promptly.

- The Department contact local law enforcement agencies and offer training courses regarding trespass on State lands.

- The Department contact Arizona's communications media regarding public service announcements dealing with trespass on State lands.

INTRODUCTION AND BACKGROUND

In response to a June 19, 1979, resolution of the Joint Legislative Budget Committee, we have conducted a performance audit of the State Land Department in accordance with A.R.S. §41-1279.

The scope of the audit was directed mainly to the Natural Resources Division, Contracts and Records Division and Board of Appeals; it did not include a detailed review of Administrative Services, Forestry Management or Urban and Commercial Development. A separate report entitled "A Performance Audit of the Arizona Resources Information System" was released in March 1980 by our Office on the Information Resources Division of the State Land Department.

In 1915 the Arizona Legislature created the State Land Department to "...administer all laws relating to lands owned by, belonging to, and under the control of the state." The Governor was empowered to appoint a Land Commissioner to administer the Department.

Acting as trustee, the State Land Department's primary responsibility originally was to manage approximately 10.7 million acres of Federal land granted to 13 Arizona beneficiaries. Those Federal land grants date back to 1863 when the Territory of Arizona received sections 16 and 36 of each township, to be held in trust for the benefit of common schools within Arizona. In 1910, sections 2 and 32 of each township were added to the common school endowment, and an additional 2.35 million acres were granted to 12 other Arizona beneficiaries. Table 1 lists the acreages granted to the 13 original beneficiaries.

TABLE 1

TRUST LANDS MANAGED BY THE STATE LAND DEPARTMENT
WHICH WERE GRANTED TO STATE BENEFICIARIES
BETWEEN 1863 AND 1910*

Beneficiary	Original Acreage Granted	Acreage Remaining In 1979
University	200,000	164,994.40
Legislative, Judicial, Executive	100,000	66,660.29
Penitentiary	100,000	80,830.52
Asylum for the Insane	100,000	79,116.44
School and Asylum for the Deaf, Dumb and Blind	100,000	84,209.03
Miners' Hospital	50,000	48,648.54
Normal School	200,000	172,524.62
State Charitable, Penal and Reformatory	100,000	79,324.64
Agriculture and Mechanical Colleges	150,000	134,469.14
School of Mines	150,000	132,902.27
Military Institutes	100,000	82,944.65
County Bonds	1,000,000	799,283.22
Common Schools**	8,334,972	7,534,809.93
Total	10,684,972	9,460,717.69

* It should be noted that the acreages granted represent surface measurements. Subsurface ownership may differ significantly from surface ownership.

** Since several of the sections 2, 16, 32 and 36 of the common school grant were already under private ownership or Federal reserve, the State was allowed to make selections in lieu of the reserved acreage. The measurements shown represent selections and grants.

In addition to the 9,460,717 acres originally granted, the Department manages 109,236 acres of subsequently granted land and 12,021 acres of State-owned land for a grand total of 9,581,974 acres. The acreage granted to the original 13 beneficiaries constitutes more than 98 percent of the land currently managed by the Department.

The Enabling Act of Arizona imposes a fiduciary responsibility upon Arizona regarding State trust lands. Section 28 of the Enabling Act for Arizona states:

> "...it is hereby declared that all lands hereby granted, including those which, having been heretofore granted to said Territory, and hereby expressly transferred and confirmed to the said State, shall be by the said State held in trust,..."

The State Legislature delegated this responsibility to the State Land Department. In keeping with its fiduciary responsibility, the Department is expected to obtain fair market value for the lands and products of the land such as minerals, timber, oil and gas. Section 28 of the Enabling Act further states:

> "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....
>
> . . . . . .
>
> "All lands, leaseholds, timber and other products of land, before being offered, shall be appraised at their true value, and no sale or other disposal thereof shall be made for a consideration less than the value so ascertained....
>
> . . . . . .

> "Every sale, lease, conveyance, or contract of or concerning any of the lands hereby granted or confirmed, or the use thereof or the natural products thereof, not made in substantial conformity with the provisions of this Act shall be null and void, any provisions of the constitution or laws of the said State to the contrary notwithstanding."

In addition, a 1951 court case (State ex rel. Ebke v. Board of Educational Lands and Funds et al.), the Supreme Court of Nebraska declared that a state must obtain a maximum return for trust land. The court declared that:

> "The state as trustee owes the beneficiaries of the trust its undivided loyalty and good faith, and its acts must be in the sole interest of such beneficiaries.
>
> "An act of the Legislature dealing with trust property of which the state is the trustee constitutes a breach of trust where it appears that it substantially benefits a special class of persons at the expense of the trust estate.
>
> "It is the duty of a trustee to obtain a maximum return to the trust estate from the trust properties under its control...."

Sources of revenues from trust lands are lease royalties and rentals, land sales, interest earnings and service fees. Table 2 summarizes trust land revenues from fiscal years 1974-75 through 1978-79.

TABLE 2

STATE LAND DEPARTMENT REVENUES FOR ALL TRUSTS EARNED FROM 1974-75 TO 1978-79

	1974-75	1975-76	1976-77	1977-78	1978-79
Lease Revenues	$ 4,454,571	$ 4,715,532	$ 4,990,440	$ 6,297,070	$ 6,319,363
Land Sales (Principal)	2,435,900	2,847,793	2,854,562	3,829,325	7,894,939
Other Receipts	5,468,285	3,926,346	4,738,126	3,682,933	5,000,784
Total	$12,358,756	$11,489,671	$12,583,128	$13,809,328	$19,215,086

In the 1978-79 fiscal year the Department received royalty fees of $3,403,930 which are included with other receipts in Table 2.

The Department leases trust lands for a variety of uses. Table 3 summarizes the number of acres leased and details the revenues generated during fiscal year 1978-79 for each type of lease.

TABLE 3

SUMMARY OF STATE LAND DEPARTMENT LEASE RECEIPTS
FOR THE 1978-79 FISCAL YEAR AND ACRES
LEASED AS OF JUNE 30, 1979

Type of Lease	Receipts	Acres
Surface		
U.S. contracts	$ 982,288	93,840
Grazing	874,412	8,757,461
Right of way	870,245	95,401
Commercial	807,586	284,937
Agriculture	621,376	158,647
Special use permits	79,310	180,696
Homesites	8,627	415
Total surface	$4,243,844	9,571,397
Subsurface		
Oil and gas	$1,687,217	6,262,930
Prospecting permits	326,965	292,034
Mineral	39,380	44,315
Mineral materials	14,799	12,404
U.S. contracts	3,750	46,243
Geothermal	3,408	1,844
Total subsurface	2,075,519	6,659,770
Total surface and subsurface	$6,319,363	

Although the beneficiaries receive the interest revenues generated by the trust, they are not required to defray costs incurred by the Department in administering those lands. Instead, most of the costs are financed through the Department's General Fund appropriation. Table 4 summarizes the Department's expenditures during fiscal years 1975-76 through 1978-79 and 1979-80 estimated.

TABLE 4

SUMMARY OF STATE LAND DEPARTMENT EXPENDITURES
FROM FISCAL YEARS 1975-76 THROUGH 1979-80*

Operating Budget	1975-76 (Actual)	1976-77 (Actual)	1977-78 (Actual)	1978-79** (Actual)	1979-80 (Estimate)
FTE*** positions	95.8	87.0	107.0	108.0	97.0
Personal services	$1,106,771	$1,065,700	$1,316,789	$1,488,533	$1,519,100
Employee-related expenditures	161,036	156,700	240,861	277,211	299,100
Professional and outside services	6,700	22,000	16,069	63,376	60,000
Travel:					
In-State	48,594	41,100	71,297	73,278	80,300
Out-of-State	3,302	2,500	3,659	3,566	4,000
Other operating expenditures	178,214	243,900	302,014	282,358	222,400
Capital outlay	11,362	2,100	52,673	76,993	1,000
Other expenditures				23,880	100,000
Subtotal	1,515,979	1,534,000	2,003,362	2,289,195	2,285,900
Fire protection payments		25,000	20,172	35,000	55,000
Natural resource conservation districts	80,000	80,000	79,902	80,153	82,300
Groundwater transfer****		1,300	208,134	265,604	
Floodplain land exchange					150,000
Allotment management plans		600	4,386		
Total	$1,595,979	$1,640,900	$2,315,956	$2,669,952	$2,573,200

* The Department administers other programs not related to trust responsibility such as the natural resource conservation district. According to Department officials less than 10% of the appropriations are expended for these activities.

** Includes the information resources division (Arizona Resources Information System) which was transferred from the Department of Revenue to the State Land Department in May 1978.

*** Full-time equivalency.

**** The Water Division and the Groundwater Transfer Program were transferred to the Arizona Water Commission in 1979.

The Office of the Auditor General expresses its gratitude to the State Land Department personnel for their cooperation, assistance and consideration during the course of the audit. The Land Department is to be commended for the initiative it has shown in implementing recommendations made in the trespass and mine production report findings.

FINDING I

IF ARIZONA'S ROYALTY RATE FOR THE EXTRACTION OF METALLIFEROUS MINERALS FROM STATE LANDS WERE COMPARABLE TO THAT OF OTHER STATES, REVENUES FROM MINERAL LEASES WOULD HAVE BEEN AS MUCH AS $6.5 MILLION MORE DURING 1979.

As of July 1, 1980, Arizona was one of ten states that leased State lands to private entities for the extraction of metalliferous minerals.* However, when compared to the nine other states, Arizona has one of the lower royalty rates. If Arizona's royalty rate were comparable to the other lessor states, revenues from mineral leases would have been as much as $6.5 million more during 1979. In addition, the adoption of a royalty method based on the gross value of the minerals extracted would reduce paperwork for the private lessees and allow for more efficient and effective review by the State Land Department.

Low Royalty Rate

A.R.S. §27-234(B) provides that:

> "Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. The net value shall be deemed to be the gross value after processing, where processing is necessary for commercial use, less, the actual cost of transportation from the place of production to the place of processing, less costs of processing and taxes levied and paid upon the production thereof."

* Appendix I is a summary of survey results regarding leasing policies of the states that lease state-owned lands to private entities for the extraction of metalliferous and nonmetalliferous minerals.

The other nine states that lease state lands to private entities for the extraction of metalliferous minerals from state lands use one of the following methods to assess royalties (see Appendix I):

1. Percentage of gross revenues,

2. Sliding percent of gross revenues based on gross value per ton,

3. Sliding percent of net revenues based on gross value per ton,

4. Percentage of net revenues, or

5. Net rate per ton.

Table 5 summarizes the methods used by the ten lessor states to determine mineral royalties and shows the impact each method would have had on Arizona royalty revenues from January 1, 1979, through December 31, 1979.*

* During fiscal year 1979-80, the State Land Department received 99.96% of its royalties from mineral production from four major mining lessees (see Appendix II). During this period, the Department received the remaining .04% of royalties from more than 300 other mining lessees. As a result, the Office of the Auditor General restricted its review of the royalty issue to the four major lessees.

TABLE 5

COMPARISON OF MINING ROYALTY ASSESSMENT METHODS USED BY THE TEN STATES WHICH LEASE STATE LANDS TO PRIVATE ENTITIES FOR THE EXTRACTION OF METALLIFEROUS MINERALS AS OF JULY 1, 1980, AND THE IMPACT EACH METHOD WOULD HAVE HAD ON ARIZONA ROYALTY REVENUES FROM JANUARY 1 THROUGH DECEMBER 31, 1979*

State	Method Used to Calculate Royalties**					Royalties that Arizona Would Have Received under the Various Royalty Methods During 1979	Impact [Increase/(Decrease)] Each Method Would Have Had on Arizona Royalty Revenues During 1979	
	Percentage Gross Revenues	Sliding Percent of Gross Revenues Based on Gross Value per Ton	Sliding Percent of Net Revenues Based on Gross Value per Ton	Percentage of Net Revenues	Net Rate Per Ton		Increase (Decrease) Amount	Increase (Decrease) Percentage
California				10.00%		$12,675,024	$ 6,514,932	106%
Michigan		3 to 6%***				6,416,322	256,230	4%
Montana	5.00					10,693,870	4,533,778	74%
Tennessee	5.00					10,693,870	4,533,778	74%
Texas	6.25					11,788,092	5,628,000	91%
Idaho			$.25 to 10.00%****			3,485,631	(2,674,461)	(43%)
Utah				4.00%		5,070,009	(1,090,083)	(18%)
ARIZONA				5.00%		6,160,092	-0-	-0-
Washington				4.00%*****		5,070,009	(1,090,083)	(18%)
Minnesota					$.60	5,457,285	(702,807)	(11%)

* Projections of royalties in the other nine states are based on royalty payments from Arizona's four largest State mineral leases which comprise over 99.9% of the mineral royalties Arizona received in the 1979-80 fiscal year. Mineral leases on the four mines currently producing are in effect for 20 years with the earliest expiration date being 1985 and the latest expiration date being 1994.

** As used in this table, net revenues include deductions for processing, transportation and/or taxes made before the royalty is calculated. Gross revenues include no deductions before the royalty is calculated.

*** Michigan's royalty rates vary from 3% to 6%. Based on Arizona mining activity in 1979, 3% was used in this table.

**** Idaho's royalty rates vary from $.25 per ton to 10% of net revenues. Based on Arizona's mining activity in 1979, 2.75% was used in this table.

***** The minimum rate is 4% of net revenues; however, that rate is negotiable and could increase substantially depending on the appraised value of the land being leased.

As shown in Table 5, five states charge higher royalty rates than Arizona does, and four of the five charge rates that are significantly higher than Arizona's. Washington shows a royalty rate lower than Arizona's, but four percent of net revenues is the minimum rate charged. Washington's royalty could be substantially higher depending on the appraised value of the land which is leased.

Further, most of the other lessor states, unlike Arizona, have adopted higher royalty rates within the last ten years, as shown in Table 6.

TABLE 6

SUMMARY OF CURRENT AND HISTORIC ROYALTY RATES CHARGED
BY STATES TO PRIVATE ENTITIES FOR THE EXTRACTION OF METALLIFEROUS MINERALS

State	Code or Statute Citation	Current Royalty Rate	Can Rate Be Adjusted By Department?	Year Current Rate Enacted	Royalty Rate Prior to Most Recent Change	Method of Change in Royalty Rate
ARIZONA	§27-234	5% of net production value	No	1941	2-5% of net production value	Statutory revision
California	PUBR 6895	Not less than 10% of gross production value (less transportation and processing costs)	Yes	1976	State Land Commission established rate at 7 1/4% of net production value in 1971	Statutory revision
Idaho	47-704	Not less than 2 1/2% of gross production value (which includes deductions for transportation and processing costs similar to Arizona's calculation of net revenue)*	Yes	1967	State Land Commission established rate at $.25 per ton produced in 1957	Statutory revision
Michigan	13-727	Royalty rate to be set by State Conservation Department**	Yes	1973	Not less than 4% of net production value	Statutory revision
Minnesota	93-20	$.60 per ton for new leases	Yes	1979	State Land Department established royalty rate of $.05 to $.10 per ton in 1969	Administrative decision
Montana	77-3-116	Not less than 5% of gross production value	Yes	1973	Not more than 5% of net production value	Statutory revision
Tennessee	49-113	Not less than 5% of gross production value	Yes	1971	State Land Department established rate at not more than 5% of gross production value in 1956	Administrative decision
Texas	5421C.8	Not less than 6 1/4% of gross production value	Yes	1957	Not less than 6 1/4%***	Statutory revision
Utah	65-1-18	Not more than 12 1/2% of gross production value****	Yes	1976	Sliding scale of 3% to 6% gross extractions	Statutory revision
Washington	79-01-644	Not less than 4% of net production value	Yes	1976	Not less than 1% of net production value	Administrative decision

* The Idaho Department of Lands has adopted a "sliding scale" for royalties on production of minerals. The rate increases from $.25 ton to 10% of net revenues as the value of the ore removed increases. The rate is applied to the net production value of ore taken from the leased lands.

** The Michigan Conservation Department has established a royalty rate of 3% to 6% of gross production value, based on the Department's appraisal of the area in which the mine is located.

*** Prior to 1957, the Texas code did not specify whether the royalty rate was based on gross or net production value. The 1957 statutory revision required lessees to pay royalties based on gross production value.

**** The Utah State Lands Board had adopted a "sliding scale" for royalties on production of minerals. The rate increased from 3% to 12 1/2% as the value of the ore removed increased. The rate was applied to the gross production value of ore taken from the leased lands less transportation and processing costs. In 1980, the Utah State Lands Board changed the royalty to 4% of gross less transportation and processing costs.

As shown in Table 6, Arizona has not adjusted its royalty rate since 1941 and is the only state leasing State lands to private entities for the extraction of metalliferous minerals that has not adjusted its royalty rate in the last 25 years. In addition, California, Michigan, Minnesota, Montana, Tennessee, Utah and Washington have substantially increased their royalty rates in the last ten years.

Arizona is the only state listed in Table 6 that does not allow the agency that administers mining leases to set royalty rates. To ensure that the administering agency does not abuse that authority, many state statutes provide for a "floor" below which royalty rates may not fall. Thus, statutes structured in this manner provide for both an equitable return on State lands and the ability to: 1) accommodate production or operational differences between lessees, and 2) modify royalty rates to reflect fees charged by other lessor states.

Advantages of Basing
Royalties on the Gross Value
of the Minerals Extracted

The adoption of a royalty rate for the extraction of metalliferous minerals based on the gross valuation of production would not only increase State revenues but would provide the following benefits as well.

- Reporting requirements would be simplified for mines leasing land from the State.
- The State of Arizona would discontinue subsidizing lessees who operate uneconomically or inefficiently.
- The State Land Department could review and audit royalty payments more efficiently and effectively.

Currently, mines that lease State lands for the extraction of metalliferous minerals are required to prepare and submit reports to the State Land Department that detail production volume, assay percentages, invoice pricing and costs that are deductible to arrive at net valuation, against which the State's royalty rate is applied to arrive at the State's royalty payment. By adopting a gross valuation basis for royalties, lessees would no longer be required to prepare and submit detailed cost schedules with their monthly royalty statements.

An ancillary benefit of using a gross valuation basis to determine royalties would be discontinance of the current practice of the State rewarding uneconomical or inefficient mining operations. Currently, lessees are allowed to reduce the royalty amount paid to the State through deduction of production and transportation costs before calculating the State's royalty. For example, if on its monthly report a lessee claims to have extracted $1,000,000 worth of minerals from State lands and to have incurred $500,000 in deductible costs, then the State's royalty is calculated as follows:

Gross value after processing of minerals extracted from State lands	$1,000,000
Deductible costs incurred	500,000
Net value of minerals extracted from State lands	500,000
State royalty rate	5%
State royalty amount	$ 25,000

As shown above, the State, in effect, subsidizes five percent of deductible costs incurred by lessees. This practice would be eliminated, and incentives for uneconomical or inefficient mining operations that are inherent in such a practice would be removed, if State royalties were based on a gross valuation basis.

A final advantage of adopting gross valuation as the basis for royalties is that it would simplify the review and audit of monthly royalty statements by the State Land Department. This function has not been performed adequately by the Department (see Finding II) and, by eliminating the need to review and audit detailed cost schedules, the Department can perform those functions more efficiently and effectively.

CONCLUSION

1. Arizona has one of the lower mineral royalty fees among states that lease state lands for the extraction of metalliferous minerals.

2. Arizona's net value method of assessing royalty fees requires more paperwork on the part of lessees, and auditing and review by the State Land Department, than would a gross value method for determining royalty rates.

RECOMMENDATIONS

It is recommended that A.R.S. §27-234(B) be amended to provide for:

1. A greater return on State mineral royalties.

2. Assessment of royalty fees on a gross valuation rather than net valuation.

3. Giving the State Land Department authority to establish royalty rates for mining leases that provide an equitable return on State lands and that allow for production or operational differences between lessees.

FINDING II

STATUTORY AND STATE LAND DEPARTMENT ADMINISTRATIVE CHANGES ARE NEEDED TO ENSURE PROPER PAYMENT OF MINERAL ROYALTIES.

During 1979, mineral leases earned the State of Arizona approximately $6.5 million in royalties. Our review of mineral leases revealed that:

- The statutes governing mineral royalties are vague regarding the determination of mineral royalties and the timeliness of payment.
- The State Land Department has not established adequate rules and regulations regarding mineral royalties.
- The State Land Department has not adequately reviewed or audited mineral royalty payments.

As a result, it is not possible to determine if the State has been properly paid for minerals removed from State lands.

Statutory Vagueness

A.R.S. §27-234(B) provides the statutory basis for determining the amount of mineral lease royalties and states:

> "B. Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. The net value shall be deemed to be the gross value after processing, where processing is necessary for commercial use, less the actual cost of transportation from the place of production to the place of processing, less costs of processing and taxes levied and paid upon the production thereof. In case of minerals not processed for commercial use, the net value shall be the gross proceeds, or gross value, at the place of sale or use, less the actual cost of transportation from the place of production to the place of sale or use, less taxes, if any, levied and paid upon the production thereof. (Emphasis added)

The above statute is vague in that it:

- Does not specify the price basis for calculating "gross values",
- Does not define "processing,"
- Does not define "commercial use,"
- Does not stipulate what kinds of costs constitute transportation or processing costs,
- Does not specify what constitutes timely payments of royalties, and
- Does not provide for penalties for late payment of mineral royalties.

Lack of Department Rules and Regulations

The statutory vagueness regarding the calculation of mineral royalties is replicated in the State Land Department's rules and regulations, in that the Department has not established what constitutes gross production; how gross values are to be determined; how processing losses are to be determined; how processing and transportation costs are to be calculated; due dates for royalty payments; and penalties for late payment of royalties.

As a result:

- One lessee underpaid the State a conservatively estimated $125,000 during 1977 and 1978 because it did not include reprocessed copper in its gross production.
- A procedure for paying mineral royalties has evolved informally that has no basis in law or Department rules and regulations and has delayed the final payment of some royalties for as long as eight years.

Gross Production

The Department receives monthly production reports from mining lessees that are used to calculate the State's royalty payments. One of the factors for determining the State's royalty is gross production.

In order to ascertain the accuracy of gross production information on the monthly production reports filed with the Department, a comparison was made between one lessee's monthly production report and that same lessee's annual report filed with the Securities and Exchange Commission (SEC). The comparison divulged significant differences in the tons of copper produced by the lessee in 1977 and 1978. The extent of the differences is detailed in Table 7.

TABLE 7

COMPARISON OF COPPER TONS AS REPORTED BY ONE LESSEE IN STATE LAND DEPARTMENT MINERAL REPORTS AND SEC ANNUAL REPORTS IN 1977 AND 1978

	1977	1978
Tons of copper produced as reported to SEC	111,105	117,392
Tons of copper produced as reported to State Land Department	96,978	106,494
Differences in tons	14,127	10,898
Percent differences	15%	10%

When staff from the Auditor General's Office brought the above differences to the attention of the lessee, a reconciliation was prepared to explain the differences (see Appendix III). Differences were attributed primarily to adjustments to recovery rates in 1977 and copper recovered from reprocessed slag in 1977 and 1978.

The first reconciling item was the result of adjustments made by the lessee during 1977 to copper recovery rates that were not reported to the State Land Department. As a result, the lessee understated its copper production by 2,291,730 pounds. Because a portion of the ore mined by the lessee that year came from State land, the State should have received royalties on its share of the additional copper.

After discussions with the staff of the Office of the Auditor General, the lessee conceded that additional royalties were, in fact, due to the State. On May 20, 1980, the State Land Department received a check for $31,950 from the lessee for additional royalties due plus interest.

During the processing of copper ore into pure copper a slag is produced that is discarded as the copper concentrate is transferred from the reverberatory furnace to the converter and anode furnaces (see Appendix IV). From 1976 through 1979 one of the lessees extracting copper ore from State land found it economically feasible to reprocess the slag derived from the copper purification process. The copper produced from this reprocessing of slag was the other main reconciling item when the State Land Department reports were compared to the SEC reports.

In a March 28, 1980, opinion, the Legislative Council stated (see Appendix V):

> "The lessee should pay to the state royalties on copper derived from the slag which can be traced to ore extracted from leased state land by the lessee."

Legislative Council reached this conclusion because:

> "The Land Department cannot elect to receive royalties due or to receive the amount the lessee deducted for costs in reprocessing the slag. The leasing agency has no authority to release a lessee from liability for royalty deficiencies..."
>
> "The mineral lease...confers on the lessee...the obligation to 'pay as royalty 5% of the net value of the minerals produced from the leased premises.'
>
> "The terms of the statute and of the lease as to the royalty payable are clear and unambiguous and need no construction."

Thus, $125,297 is owing the State in additional royalties based on the information available from the lessee for 1977 and 1978 as shown in Table 8.

TABLE 8

COMPUTATION OF ADDITIONAL ROYALTIES DUE TO THE STATE LAND DEPARTMENT FOR ONE LESSEE'S REPROCESSING OF SLAG IN 1977 AND 1978

	1977	1978	Total
Tons of copper in reprocessed slag	12,748	11,389	24,137
	x 2,000	x 2,000	x 2,000
Converted to pounds	25,496,000	22,778,000	48,274,000
Estimated percentage of copper in slag pile that is extracted from State land	x 7.99%	x 7.99%	x 7.99%
Copper pounds traced to State land	2,037,130	1,819,962	3,857,092
Average price per pound of copper received by mine during the year	x$ .6538	x$ .6451	
Estimated net value of the copper in reprocessed slag	$1,331,876	$1,174,057	$2,505,933
Royalty percentage	x 5%	x 5%	x 5%
Additional royalty due to State Land Department	$ 66,594	$ 58,703	$ 125,297

It should be noted that processing and transportation costs were not deducted above in calculating additional royalties because the lessee had already deducted those costs in its monthly production reports filed with the Department.

It should be noted also that the $125,297 is a conservative estimate based on information available from the lessee. The amount does not include additional royalties due for 1976 or 1979. Information on reprocessed slag for 1976 and 1979 has not yet been made available to the Office of the Auditor General or to the State Land Department by the lessee.

Royalty Payment Procedures

Each month, by terms of the lease, lessees of State land for mineral extraction are required to file production reports and pay royalties due. As an example, for ore mined in February 1980, a report was due by March 20, 1980. Lessees currently file preliminary production reports as a basis for determining royalties due to the State; then make adjustments to those preliminary reports on subsequently filed reports.

The practice of filing preliminary reports has no basis in law nor is it provided for in Department rules and regulations. Further, such a practice delays final payment of royalties, for several years in some cases.

As explained above, the amount of the royalty fee paid to the State is derived from preliminary monthly production reports which are prepared by the lessees and filed with the Department 20 days after the end of the month in which the ore is mined. The final adjusted report, submitted at a later date, details changes in tonnage or shifts in the market price of the mineral. Such adjustments are reflected either as additional royalty fees paid to the State or royalty payments reduced on the current month's preliminary report.

According to the Legislative Council there is no basis in Arizona statutes or Department rules and regulations for the above procedures (See Appendix VI).

> "The Arizona statutes and the rules and regulations of the state land department do not provide for an adjusted report...There are no statutory or regulatory provisions regarding the adjusted report and therefore no deadline for such a report. The deadline in the...regulation applies to the production report or preliminary report, as it is known by the department."

Discussions with Department personnel revealed that the practice of filing preliminary reports apparently evolved informally and has never received official sanction from the Legislature or the Department.

The practice of allowing lessees to file preliminary reports has resulted in delay of final royalty payments for as long as eight years. For example, over a seven-year period, two lessees filed final reports an average of 20 months after they filed their preliminary reports.

During that seven-year period, these two lessees paid $153,000 in additional royalties when the final reports were filed. Thus, these lessees had the use of the $153,000 for an average of 20 months, free of interest charges.

A third lessee did not file a final report with the Department from August 1972 to May 1980, nearly eight years, because of a dispute regarding the assayed value of State ore mined.

In March 1980, staff from the Office of the Auditor General met with employees of the third lessee to determine why the mine abstained from filing final reports for nearly eight years. According to the lessees' employees:

1. State Land Department personnel met with the lessee on December 17, 1973. The lessee's interoffice correspondence shows that:

> "...SLD personnel indicated 'that state ore should be analyzed for the above metals' (gold, silver, molybdenum) and values determined on that basis. The basis for their proposal was that the content of gold, silver and moly would increase in direct proportion to the copper content, and, since the state ore through August, 1972 (the last final settlement) was of significant higher grade than non-state ore, values as reported have been too low..."

2. Later correspondence from the mine to Department personnel, dated September 30, 1974, indicated:

> "On January 21, 1974, (the Director of the Land Department) wrote and told us of new reporting requirements and asked us to advise him if the new requirements posed a problem.

"We have advised your office of the problems that we face in complying with the requirements and would like to obtain clarification of them.

"Could you please come to our offices so that we can show you the records and also, so we may discuss the situations with the appropriate people on our staff.

"We look forward to your reply so that we can comply with the department's requirements."

This was the last evidence of communication between the Department and the lessee until Department personnel accompanied staff from the Office of the Auditor General to the lessee's offices in January 1980.

On May 12, 1980, the State Land Department received the first of the old preliminary reports in final form from the lessee. As of July 28, 1980, final settlements from the lessee had been made for the period of September 1972 to December 1977, resulting in a net reduction in royalties to the State of $35,267.

Although current Department mineral leases stipulate that royalties shall be paid within 20 days after the close of the month within which the minerals were extracted, a Legislative Council opinion stated that:

"There is no statute prescribing the date when royalty payments are due..."

Legislative Council also noted that Texas has a statute granting the state a first lien on minerals produced to secure payment of unpaid royalties, and New Mexico has a statute requiring the lessee to furnish a bond to secure royalty payment and providing that an attempt to defraud the state of royalty is a felony. New Mexico and Texas also require that a final report for the month's business be filed in 30 days. If the report is not received by the due date, a default letter is mailed and/or interest (one percent a month on the unpaid balance) and penalties are assessed.

Inadequate State Land Department Reviews or Audits of Royalty Payments

Preliminary monthly production reports, which are used to calculate estimated mineral lease royalties, usually detail the following information:

1. Gross monthly production from State lands,
2. Gross production net of processing losses,
3. Prices used to value gross production - net of processing losses,
4. The value of the gross production net of processing losses,
5. Processing and transportation costs,
6. Taxes,
7. Net value (Item 4 less Items 5 and 6), and
8. The State's royalty amount (five percent of Item 7).

Final royalty reports, which are filed sometime later, contain an imposing volume of detailed and complicated schedules to support financial information in the reports.

Currently, both reports are reviewed by a geologist in the Department's Mineral Resources Division.

In 1979 alone, production losses and deductions allowed under the statutes reduced royalties paid to the State by approximately $11.2 million as shown in Table 9.

TABLE 9

PRODUCTION LOSSES AND DEDUCTIONS FOR PROCESSING, TRANSPORTATION AND TAXES ALLOWED UNDER THE STATUTES THAT REDUCED ROYALTIES PAID TO THE STATE FROM JANUARY 1, 1979 TO DECEMBER 31, 1979

Production Losses		
Losses on production of copper	$ 24,683,570	
Losses on production of molybendum	98,309,376	
Losses on production of silver	10,838,320	
	$133,831,266	
Royalty rate	x .05	
		$ 6,691,563
Production Costs, Transportation and Taxes		
Processing costs	$ 81,859,260	
Transportation costs	5,267,894	
Taxes	3,548,380	
	$ 90,675,534	
Royalty rate	x .05	
		$ 4,533,776
Total royalty reduction for production losses and deductions		$11,225,339

It is noteworthy that in the last eight years the Department has not challenged a single processing loss or cost deduction on a monthly royalty report.

It is not possible to determine if the royalties paid to the State are proper from the information that is submitted to the Department. During the course of the Auditor General's review, it was necessary for staff to ask lessees how certain calculations or determinations were made. This procedure was necessary because the personnel in the Department who are responsible for reviewing royalty payments did not possess a complete understanding as to how lessees calculate the State's royalty.

An additional note is that one of four primary mineral lessees refuses to file monthly production reports in a form required by the Department.

The form required by the State Land Department is a two-page form (see Appendix VII), which is filled out in its entirety by the other three primary lessees. However, the fourth lessee fills out only the first page and not the second page, which contains information on the assayed values of copper, gold, silver and molybdenum contained in the ore and processing losses.

The lease agreement between this lessee and the Department contains the following provision:

> "The lessee agrees to pay all royalties...such payments will be accompanied by a sworn statement on <u>forms</u> (emphasis added) furnished by the Department."

Legislative Council was asked about the legal ramifications regarding this situation and its opinion was (see Appendix VIII):

> "The statutes, the lease and the department's regulations do not restrict the type of information which the commissioner is authorized to obtain apart from the fact that the information must relate to the leased 'mineral claim.' (See A.C.R.R. R12-5-706, subsection C.)
>
> "The information specified in the example stated in your question (silver assay per 'dry tons ore treated.') is within the information which the state land commissioner is permitted to obtain from the lessee.
>
> "The lessee would be in violation of the lease terms if the lessee was not completing all of the forms provided by the department."

Finally, an additional hindrance to an effective Department review or audit function is that, according to the Legislative Council (see Appendix VI):

> "There is no provision for challenging the lessee's determination of value..."

Legislative Council did point out, however, that other states' statutes, such as in Texas and New Mexico, have provisions for an examination of lessees' books and records and for adjustments to royalties as a result of those examinations.

CONCLUSIONS

Current statutes are vague regarding the determination of mineral royalties and the timeliness of payment. In addition, the State Land Department has not established adequate rules and regulations regarding mineral royalties. Finally, the State Land Department has not adequately reviewed or audited mineral royalties.

RECOMMENDATIONS

It is recommended that:

A.R.S. §27-234(B) be amended to provide for:

1. More specificity regarding the price basis for calculating gross values and the timeliness of royalty payment.

2. Penalty provisions for late payments.

3. Assessment of royalty fees on gross valuation rather than net valuation (see Finding I).

4. State Land Department authority to establish royalty rates for mining leases that provide an equitable return on State lands and allow for production or operational differences between lessees (see Finding I).

The State Land Department establish more definitive rules and regulations regarding mineral royalties and reporting procedures.

If the net valuation basis is retained in the statutes, then the State Land Department should acquire the expertise to adequately review monthly mineral production reports by contracting for professional services or hiring personnel who are knowledgeable in accounting and mining procedures.

FINDING III

THE STATE OF ARIZONA WOULD RECEIVE FROM $703 THOUSAND TO $5.2 MILLION ANNUALLY IN ADDITIONAL REVENUES FROM GRAZING LEASES IF THE GRAZING LEASE RATE WERE COMPARABLE TO THAT CHARGED BY OTHER PUBLIC AND PRIVATE ENTITIES.

The Arizona State Land Department is responsible for issuing leases to persons wishing to graze animals on State lands. The amount of revenues generated by grazing leases is the product of the annual rental rate for each animal feeding on the leased land multiplied by the carrying capacity or number of animals feeding on the leased land. During fiscal year 1979-80, grazing leases were expected to generate $1,190,000 based on a calculated lease rate of 91¢ per animal unit month. The grazing lease rate charged by Arizona is significantly lower than that charged by the Federal Bureau of Land Management, nine other western states and private land owners. Arizona would earn from $703 thousand to $5.2 million annually in additional revenues from grazing leases if its grazing lease rate were comparable to that charged by those other entities.

Grazing Leases Administered by the State Land Department

Since its inception in 1915, the State Land Department has leased a large segment of State land for grazing. In fiscal year 1978-79, the Department had 8,757,461 acres under grazing lease or 91.4 percent of the 9,581,975 acres managed by the Department. Table 10 shows the revenues generated by grazing leases for fiscal years 1968-69 through 1978-79 and the estimated revenues for fiscal year 1979-80.

TABLE 10

SUMMARY OF ACTUAL REVENUES GENERATED BY GRAZING LEASES FOR FISCAL YEARS 1968-69 THROUGH 1978-79 AND ESTIMATED REVENUES FOR FISCAL YEAR 1979-80

Fiscal Year	Amount of Grazing Lease Revenues
1968-69	$ 620,252
1969-70	645,560
1970-71	753,074
1971-72	667,590
1972-73	732,543
1973-74	803,142
1974-75	972,136
1975-76	964,035
1976-77	903,730
1977-78	894,964
1978-79	874,412
1979-80 (estimated)	1,190,503

Under Arizona law, grazing lease revenues are based on two factors; the carrying capacity, or number of animals that can feed on the acreage being leased, and the annual rental rate for each animal, or animal unit, feeding on the leased acreage. Our review of State Land Department grazing leases revealed that the Department has established carrying capacities that appear to be sufficiently high when compared to carrying capacities recently developed by the Federal Bureau of Land Management. However, the annual rental rate per animal unit, which is set by statute, is much too low.

Arizona State Land Department Grazing Lease Rate Is Far Less than that Charged by Other Entities

The Arizona grazing lease rate is determined by a formula set forth under A.R.S. §37-285(B):

> "All grazing land shall be classified and appraised on the basis of its annual carrying capacity. The annual rental rate for grazing land shall be the amount determined by multiplying the carrying capacity of the lands by the annual rental rate per animal unit. The annual rental rate per animal unit shall be twenty-two percent of the average market price of cattle for the preceding year...."

Arizona currently charges by far the lowest grazing lease rate when compared to nine other western states, the Bureau of Land Management and private land owners, as shown in Table 11.

TABLE 11

COMPARISON OF ARIZONA GRAZING LEASE RATE TO THAT CHARGED BY NINE OTHER WESTERN STATES,* THE BUREAU OF LAND MANAGEMENT AND PRIVATE ARIZONA LAND OWNERS, AND THE IMPACT THE ADOPTION OF EACH RATE WOULD HAVE HAD ON ARIZONA'S GRAZING LEASE REVENUES DURING 1979

Entity**	Calculated Animal Unit Month Rate	Animal Unit Months In Arizona During 1979	Arizona Grazing Lease Revenues Using the Indicated Annual Unit Month Rate	Impact the Adoption of Each Rate Would Have Had on Arizona's Grazing Lease Revenues During 1979
ARIZONA	$ .91	1,302,662	$1,185,422	$ -0-
Wyoming	1.45	1,302,662	1,888,859	703,437
New Mexico	1.60	1,302,662	2,084,259	898,837
Utah	1.89	1,302,662	2,462,031	1,276,609
California	1.89	1,302,662	2,462,031	1,276,609
Oregon	2.50	1,302,662	3,256,655	2,071,233
Colorado	3.00	1,302,662	3,907,986	2,722,564
Washington	3.25	1,302,662	4,233,651	3,048,229
Idaho	3.50 (average)	1,302,662	4,559,317	3,373,895
Montana	3.64	1,302,662	4,741,690	3,556,268
Bureau of Land Management	1.89	1,302,662	2,462,031	1,276,609
Private land owners	4.88	1,302,662	6,356,990	5,171,568

* Nevada is not included because it has no grazing leases.
** For information on all states that responded to the Auditor General survey see Appendix IX.

It should be noted that for comparative purposes Arizona's grazing lease rate was converted to an animal unit month rate. For example, in Arizona the animal unit month rate was determined as follows:

$$\frac{\text{Average price of beef per hundred weight for the previous year X 22\%}}{12} = \text{animal unit month rate}$$

For the 1979-80 year, the State Land Department's animal unit month rate was calculated to be 91¢.

The Nine Western States

As shown in Table 11, Arizona's grazing lease rate is not only lower than the nine other western states, but its lease rate is significantly below the calculated average of $2.36 per animal unit month for all of the states. Two states, California and Utah, have rates that are adjusted annually to the same rate charged by the Bureau of Land Management.

A survey conducted by the Office of the Auditor General of the nine other western states did not prove that they had higher grazing lease rates because they offered more lessee services. For example, none of the state land departments controlled trespasses of persons or vehicles on leased grazing lands or repaired damage to land improvements caused by vandalism, and only one state land department, in Idaho, repaired damage caused by vandalism to the leased lands. The survey, however, did reveal that five state land departments had land improvement programs that included such services as reseeding grazing lands. Table 12 summarizes the results of this survey.

TABLE 12

SUMMARY OF SERVICES PROVIDED TO GRAZING LESSEES
BY ARIZONA AND THE NINE OTHER WESTERN STATE LAND DEPARTMENTS*

State	Control of Trespass	Repair Vandalism to the Lands	Repair Vandalism to Improvements	Land Improvement (reseeding, etc.)**
ARIZONA	No	No	No	No
California	No	No	No	No
Colorado	No	No	No	No
Idaho	No	Yes	No	Yes
Montana	No	No	No	Yes
New Mexico	No	No	No	No
Oregon	No	No	No	Yes
Utah	No	No	No	Yes
Washington	No	No	No	Yes
Wyoming	No	No	No	No
Total No	10	9	10	5
Total Yes	0	1	0	5

* Nevada is not included because it has no state grazing leases.

** Montana allocates two and one-half percent and Idaho and Washington allocate up to ten percent of the grazing fees received on state lands to a land improvement fund. The Utah State Legislature appropriated separately funds for land improvement equal to approximately 15 percent of the grazing fees collected in 1979-80 fiscal year. Oregon has expended for land improvement approximately 35 percent of the grazing fees collected in the last ten years.

The Bureau of Land Management

The Federal Bureau of Land Management was formed in 1946 by combining the General Land Office and the Grazing Service. Presently, the Bureau of Land Management (BLM) manages more than 450 million acres of public lands in 23 states, making it the nation's largest land manager.

In Arizona, BLM manages 12,596,043 acres of public lands, of which 12,289,000 acres (98 percent) are leased for grazing. Table 13 illustrates how State Land Department grazing rates have fallen below the rates charged by BLM in recent years.

TABLE 13

COMPARISON OF GRAZING FEES CHARGED BY THE ARIZONA STATE LAND DEPARTMENT AND BUREAU OF LAND MANAGEMENT FOR FISCAL YEARS 1959-60 THROUGH 1979-80

Fiscal Year	State Land Department	Bureau of Land Management
1959-60	$.42	$ .22
1960-61	.43	.22
1961-62	.39	.19
1962-63	.39	.19
1963-64	.41	.30
1964-65	.39	.30
1965-66	.35	.30
1966-67	.39	.33
1967-68	.43	.33
1968-69	.43	.33
1969-70	.45	.44
1970-71	.50	.44
1971-72	.49	.64
1972-73	.55	.66
1973-74	.63	.78
1974-75	.81	1.00
1975-76	.69	1.00
1976-77	.66	1.51
1977-78	.65	1.51
1978-79	.68	1.51
1979-80	.91	1.89

In 1953, the General Accounting Office issued several audit reports that noted inconsistencies in the methods grazing fees were established by Federal agencies and were critical of the low fees charged by the Bureau of Land Management. The Comptroller General's report of 1958 recommended that a joint study be undertaken to arrive at a uniform method for establishing Federal agency grazing fees.

Based on a 1966 Western Livestock Grazing Survey,* the Bureau of Land Management in 1969 adopted regulations that provided for: 1) a schedule of incremental increases in the Bureau's $.33 grazing fees rate to $1.23 over a ten-year period, and 2) annual adjustments to the grazing fee rate to reflect charges in rates paid on privately held rangelands in eleven Western states.

The Congress of the United States passed the Public Rangelands Improvement Act of 1978,** which stipulated that: 1) the Bureau's grazing fee rate equals the fair market value of the land leased, and 2) the fair market value for public grazing should equal the $1.23 base established by the 1966 Western Livestock Grazing Survey multiplied by the Forage Value Index (FVI)*** plus the Beef Cattle Price Index (BPI)*** minus the Prices Paid Index (PPI)*** and divided by 100. Stated algebraically, the formula is:

$$\text{Grazing fee per animal unit month} = \frac{\$1.23\ (FVI + [BPI - PPI])}{100}$$

* The Statistical Reporting Service, U.S. Department of Agriculture, cooperated with the Forest Service and Bureau of Land Management to plan and carry out the data collection and compilation for the survey. The survey encompassed 98 national forests, 19 national grasslands, 48 BLM districts and 10,000 individuals in 17 western states.

** In October 1973, the American National Cattlemen's Association (ANCA) proposed a new index to the Secretaries of Agriculture and Interior to replace the index that was currently in use by BLM. The index proposed by ANCA formed a significant part of the grazing formula used to establish "fair market value" in the 1978 Public Rangelands Improvement Act.

*** For further explanation of these terms see Appendix X.

Based on the above formula, the calculated fair market value of public grazing lands for fiscal year 1979-80 was $2.03 per animal unit month. It should be noted, however, that the Bureau charged $1.89 per animal unit month because the Bureau's grazing fee rate for fiscal year 1978-79 was $1.51 per animal unit month and 43 USC 1905, Section 6(a) states, "...the annual increase or decrease in such fee for any given year shall be limited to not more than plus or minus 25 per centum of the previous year's fee."

Thus, $1.51 per animal unit month X 125 percent equals $1.89 per animal unit month.

Private Land Owners

The U.S. Department of Agriculture - Economics, Statistics and Cooperative Service provides the Bureau of Land Management and the Forest Service with a derived index of the relative change in the previous year's average monthly rate per animal unit month for grazing animal units on nonirrigated private permanent pasture or grazing land. This index is used as a factor in the annual updating of the grazing fee formula used by the Bureau of Land Management and the Forest Service.

The private grazing lease rates are determined from a probability survey utilizing ranching areas and several specific lists of operators in eleven western states. The area sampling involves subdividing the entire area within each state into small area sampling units, called segments, and selecting a sample of these segments to be enumerated personally by trained interviewers. In the eleven western states the sample ranching areas have been stratified on land use. Producers must have a minimum number of livestock to be included in this classification. The statistically weighted private grazing lease rates are compared to State Land Department rates in Table 14.

TABLE 14

A COMPARISON OF ARIZONA STATE LAND DEPARTMENT
AND PRIVATE GRAZING LEASE RATES FOR 1977, 1978 AND 1979

Year	Private Grazing Lease Rate per Animal Unit Month	State Land Department Grazing Lease Rate per Animal Unit Month
1977	$3.89	$.65
1978	3.42	.68
1979	4.88	.91

It should be noted that in an October 21, 1977, report entitled "Study Of Fee For Grazing Livestock On Federal Lands," the Secretaries of the Interior and Agriculture determined a value for grazing lands which is designed to be "...equitable to the United States and to holders of grazing permits and leases." The study stated "The 1966 survey* and analysis attempted to develop a variable value base on forage quality, but significant differences could not be substantiated." The same report also stated, "Differences among ranching areas, as shown by the data, were not large enough in relation to the wide variation that existed within areas to provide a basis for recommending differential base fees among ranching areas." (Emphasis added)

Thus, it appears that grazing fee rates per animal unit month should be approximately the same throughout the western states. Further, in Arizona differences in quality and quantity of forage would be recognized in carrying capacity or the number of animal units that could properly be run in the various rangeland areas.

* The survey was designed to provide data needed to estimate grazing values on some 98 national forests, 19 national grasslands, and 48 Bureau of Land Management districts in 17 western states.

CONCLUSION

The State Land Department charges a grazing fee rate that is significantly lower than the rate charged by the Bureau of Land Management, nine other western states and private industry. If Arizona's grazing fee rate were comparable to that charged by other public and private entities, Arizona would receive from $703 thousand to $5.2 million in additional revenues from grazing leases.

RECOMMENDATION

A.R.S. §37-285(B) be amended to allow for a substantial increase in the annual rental rate charged for each animal feeding on State land. Consideration should be given to adoption of the Bureau of Land Management's grazing rate formula as established by the Congress of the United States in the Public Rangelands Improvement Act of 1978.

FINDING IV

THE LEGISLATURE HAS NOT SPECIFICALLY DIRECTED THE STATE LAND DEPARTMENT TO IDENTIFY AND RESOLVE INSTANCES OF TRESPASS ON STATE LANDS NOR HAS IT PROVIDED THE DEPARTMENT WITH ADEQUATE RESOURCES TO DO SO. AS A RESULT, DURING 1979 AT LEAST $786,000 IN DAMAGE WAS INFLICTED ON STATE LANDS BY TRESPASSERS AND A RELATED $2.3 MILLION IN COMPENSATION MAY BE LOST.

Damages May Be Lost to the State

Under Arizona law the State Land Department is responsible for managing, protecting and preserving State lands. However, the identification and resolution of instances of trespass on State lands is not specifically included in that responsibility. As a result:

- The Department does not have sufficient staff committed to trespass activities.
- The Department does not have a formal program to monitor State lands for instances of trespass.
- The Department does not have adequate procedures to resolve identified instances of trespass.
- An unknown but potentially substantial amount of damage is inflicted upon State lands by trespassers.
- A potential $2.3 million in compensation resulting from 1979 trespass damage may be lost to the State.

Lack of Statutory Requirement
to Identify and Resolve Instances
of Trespass on State Lands

A.R.S. §37-501 provides that:

> "A person is guilty of a class 2 misdemeanor who:
>
> "1. Knowingly commits a trespass upon state lands, either by cutting down or destroying timber or wood standing or growing thereon, or by carrying away timber or wood therefrom, or by mowing, cutting or removing hay or grass thereon or therefrom, or grazing livestock thereon, unless he has an application pending for leasing the lands or the lands are then leased to any other person.
>
> "2. Knowingly extracts or removes oil, gas, coal, mineral, earth, rock, fertilizer or fossils of any kind or description therefrom.
>
> "3. Knowingly without right injures or removes any building, fence or improvements on state lands, or unlawfully occupies, plows or cultivates any of the lands.
>
> "4. With criminal negligence exposes growing trees, shrubs or undergrowth standing on state lands to danger or destruction by fire."

Although the State Land Department is given the responsibility to protect and to preserve State lands held in trust and to manage those lands for the benefit of Arizona's public schools and other beneficiaries it is not statutorily required to enforce the provisions of A.R.S. §37-501.

In a memorandum dated May 28, 1980, the Legislative Council stated (See Appendix XI for entire text):

"There is no law which specifically imposes a duty upon the (State Land) department to investigate and resolve cases of trespass upon state lands. However, A.R.S. §37-211, subsection A, paragraph 4 does provide that:

" A. The State Land Commissioner may conduct investigations and experiments on the lands of the state to:

. . . . . .

"4. Obtain other information and data which will aid in the leasing, sale and administration of lands belonging to the state." (Emphasis added)

The Department Does Not Have Sufficient Staff Committed to Trespass Activities

The State Land Department is responsible for 9.6 million surface acres of State land that is scattered throughout Arizona's 72.7 million acres. Of 97 full-time equivalent positions in the Department, not one full-time employee is assigned to identify, review and investigate trespass cases.

A survey conducted by the Office of the Auditor General (See Appendix XII) revealed that there are 19 other states that have at least one full-time investigator assigned to controlling trespass activity. When compared to these 19 other states, it appears that Arizona is not committing sufficient resources to trespass activities, as shown in Table 15.

TABLE 15

SUMMARY OF STAFF ASSIGNED TO TRESPASS ACTIVITIES FOR THE 19 STATES WITH TRESPASS INVESTIGATORS AND ARIZONA

State*	Acres of State Land	Full-time Staff Assigned to Trespass Activities	Ratio of Staff to Acres of State Land
Alabama	50,000	4	1: 12,500
New Hampshire	115,000	4	1: 28,750
Rhode Island	40,000	1	1: 40,000
Wisconsin	94,000	1	1: 94,000
Illinois	1,300,000	10	1: 130,000
California	4,610,000	30	1: 153,667
New York	3,250,000	12	1: 270,833
Tennessee	600,000	2	1: 300,000
Nebraska	1,200,000	3	1: 400,000
Hawaii	500,000	1	1: 500,000
Colorado	3,000,000	5	1: 600,000
Michigan	4,400,000	7	1: 628,571
New Jersey	700,000	1	1: 700,000
Washington	3,000,000	4	1: 750,000
Florida	1,629,392	2	1: 814,696
Idaho	3,000,000	3	1: 1,000,000
New Mexico	9,200,000	9	1: 1,022,222
Texas	23,000,000	16	1: 1,437,500
Pennsylvania	3,830,000	1	1: 3,830,000
ARIZONA	9,600,000	1/2**	1: 19,200,000

* Listed in order from the lowest staff/acre ratio to the highest staff/acre ratio. Appendix VI contains additional information for the listed states.

** Effective January 1, 1980, the Arizona State Land Department assigned one full-time employee to trespass activities. This employee's time is allocated as follows: 50% of time to trespass issues; 50% to natural resources areas. Therefore, staffing is stated as 1/2 FTE.

While the comparison with other states as shown in Table 15 indicates that sufficient State Land Department staff is not committed to trespass activities, a review of known trespasses on Arizona State-owned land similarly indicates that the level of Department resources currently devoted to the area of trespass is inadequate.

Further, our review of the State Land Department revealed that the Department does not have a formal program to monitor State lands for instances of trespass or adequate procedures for resolving reported instances of trespass. As a result, an unknown but potentially substantial amount of damage is inflicted on State lands by trespassers.

The Department Does Not Have a Formal Program to Monitor State Lands

From December 1, 1977 to December 1, 1979, 135 cases of alleged trespasses on State land were reported to the State Land Department. These 135 cases were reported by the following sources:

Source	Number of Trespass Cases Reported	Percentage of Reported Cases
Law enforcement agencies	24	18%
Private citizens	26	19
Lessees	30	22
Other governmental agencies	27	20
State Land Department	28	21
	135	100%

It is noteworthy that the State Land Department identified only 21 percent of the trespass cases shown above. Such a small representation clearly indicates the absence of a formal program within the Department to monitor State lands for instances of trespass. Further, the seriousness of the absence of such a program is compounded by the fact that, according to Department personnel estimates, only 20 percent of trespasses on State land are reported to the Department.

It appears that one efficient means to increase the identification of trespass on State lands would be to better educate law enforcement agencies and the public at large regarding trespasses on State lands. For example, the Office of the Auditor General contacted the following law enforcement agencies to determine their ability and willingness to assist the State Land Department in identifying instances of trespass on State lands.

Coconino County Sheriff	Pinal County Sheriff
Maricopa County Sheriff	Yavapai County Sheriff
Pima County Sheriff	Phoenix Police Department

All the above agencies stated that: 1) their resources were limited, and 2) they could not devote additional resources to identification of trespass on State land. However, these agencies indicated that trespass identification might be increased if the Department provided them with training regarding trespass on State lands.

Additionally, despite the fact that the State Land Department does not have a formal program of education for the public regarding trespass, private citizens identified 19 percent of the trespasses reported to the Department between December 1, 1977 and December 1, 1979.

The Office of the Auditor General contacted several Arizona television and radio stations and determined that these stations would be willing to air public service announcements regarding trespass on State land for the State Land Department, provided:

- The Department prepared a statement explaining the purpose of such messages and assured the station that the messages were from a nonprofit organization, and
- The Department typed the scripts for such announcements.

By utilizing public service announcements, the Department could: 1) increase the identification and reporting of trespasses, and 2) put potential trespassers on notice as to what constitutes a trespass and what the attendant penalties are for trespassing on State land.

The Department Does Not Have Adequate Procedures to Resolve Identified Instances of Trespass

Of the 135 cases of trespass reported to the State Land Department between December 1, 1977 and December 1, 1979, 91 were still unresolved as of January 10, 1980, and the average age of these unresolved cases was 428 days. Table 16 summarizes the status of the trespass cases reported to the Department from December 1, 1977 to December 1, 1979.

TABLE 16

SUMMARY OF TRESPASS CASES REPORTED TO THE STATE LAND DEPARTMENT FROM DECEMBER 1, 1977, TO DECEMBER 1, 1979, AND THE STATUS OF THESE CASES AS OF JANUARY 10, 1980

Period Trespass was Reported to the State Land Department	Number of Trespass Cases Received	Number of Trespass Cases Resolved	Open Trespass Cases as of January 10, 1980
December 1, 1977 to December 1, 1978	78	31	47
December 2, 1978 to December 1, 1979	57	13	44
Totals	135	44*	91
Average age of unresolved trespass cases as of January 10, 1980			428 days

* There is not adequate documentation in the State Land Department files to determine how or why ten of these 44 trespass cases were closed.

A major cause of the State Land Department's inability to resolve trespass cases in a timely manner is that the Department has not established a formal procedure for trespass review and investigation.

Currently, reports of trespass on State land are sent initially to the Director of the Contracts and Records Division within the State Land Department. The Director, who devotes only a small fraction of his time to trespass, must request assistance from another Department division to conduct an on-site investigation of a trespass. Such an investigation usually does not occur until Department personnel are routinely scheduled to be in the vicinity of an alleged trespass. These investigations normally occur within 60 days of the initial reporting, but several cases were observed that were not investigated until 120 days after initial reporting.

Once an on-site investigation is completed, a report is prepared and sent to the Contracts and Records Division for the Director's review and comments. In many cases the investigation report does not contain sufficient information, and another investigation is required, resulting in further delays.

In addition, as of January 1980, the following conditions were observed within the State Land Department regarding trespasses.

- Priorities have not been established for reported trespasses. As a result, potentially serious trespass cases are treated routinely.
- A log is supposed to be maintained for recording initial reports of trespass. However, several reported trespasses are not recorded in the log.
- There is no regular or systematic review made of open trespass cases to ensure that appropriate steps have been taken to resolve them.

The absence of adequate resources and procedures within the State Land Department to investigate and resolve trespasses has resulted in trespass cases left unresolved for excessive periods of time. As a consequence, appropriate action cannot be taken against many trespassers because: 1) the trespasser may have relocated, 2) evidence of the trespass may have been destroyed by the time an investigation is made, and 3) the Department may be precluded from criminal action against a trespasser because of the statute of limitations.

In a memorandum dated February 22, 1980, the Arizona Legislative Council stated (See Appendix XIII for entire text):

> "The statute of limitations for initiating a criminal proceeding for most criminal trespasses is one year, and the state is subject to the statute of limitations."

An Unknown but Potentially Substantial Amount of Damage is Inflicted on State Lands by Trespassers

Based on one review of the State Land Department, it appears that an unknown but potentially significant amount of damage is inflicted on State lands by trespassers. For example, of the 135 trespass cases that were reported to the State Land Department between December 1, 1977, and December 1, 1979, several fall into potentially destructive categories, as shown below:

Type of Trespass Reported	Number of Trespasses Reported
Dumping on State land	24
Removal of:	
Native plants	8
Minerals	14
Destruction of fences	8
Destruction of State land	16
Unauthorized improvements	19
Other unauthorized use	46
Total	135

Further, several of the trespass files at the State Land Department contain documentation that clearly attests to the destructiveness of some trespasses. The following is a synopsis of three noteworthy trespass files.

CASE I

On March 29, 1979, the State Land Department was informed that a labor training center had been conducting a blasting and drilling school on State land since March 1973. The center claimed that it did not learn of the State's ownership of the land until March 1, 1979. On September 20, 1979, a State Land Department employee filed a report which stated that there was severe and extensive damage to the land and that major restoration would be required.

On April 19, 1979, the Department sent a letter to the trespasser which stated, in part:

> "...they (the trespassers) should approach the State Land Department for a Special Land Use Permit. It may be helpful in the community to have such a blasting and drilling training program, if so, then the State Land Department could provide for such a permit."

CASE II

On April 18, 1978, the State Land Department was notified that unauthorized individuals were using State lands without paying lease rental fees. An investigation by the Department revealed that: 1) the land had been leased to a private individual, and 2) the lease had been canceled for nonpayment of rental fees. However, as of January 10, 1980, the individual still was using the State land in question.

It should be noted that this trespass involved State land along the Colorado River. The lease authorized the individual to use the State land for a boat dock. According to the State Land Department, there are approximately 3,000 boat docks on State land along the Colorado River without permits from the Department. The Department has made an effort to identify unauthorized uses of State land for boat docks along the Colorado River and has established a fee schedule to bill individuals who are using the land. However, Department officials stated that it will be difficult for the Department to enforce the new schedule because of a lack of resources.

CASE III

On September 28, 1979, the State Land Department was notified that a lessee had removed native plants illegally from leased State lands. An investigation revealed that native plants had, in fact, been removed. The chart below lists the number and type of native plants removed between 1975 and September 1979.

Type of Native Plants Removed Illegally	Number of Plants Removed*
Agave	190
Barrel	2,625
Cholla	1,565
Hedgehog	1,535
Ocotillo	200
Prickly pear	1,357
Saguaro	1,228
Yucca	5

Total damages to the State trust as a result of this trespass are at least $161,600. The file still was open as of January 10, 1980.

Finally, our review of State Land Department trespass files revealed that at least $786,000 in damage was inflicted on State lands during 1979 alone, as detailed below.

Type of Trespass	Estimated Damage to State Land
Destruction of State land	$555,000
Removal of minerals	45,981
Removal of native plants	161,660
Unauthorized improvements on State land	7,200
Dumping on State land	10,000
Other unauthorized use of State land	6,250
Total estimated damages	$786,091

* Based on State Land Department records and an investigation by the Arizona Agriculture and Horticulture Commission.

It should be noted that the above estimate is the minimum amount of damage inflicted on State lands during 1979 in that: 1) the estimate was derived from trespass files in the State Land Department and several of those files did not contain any estimate of damage, and 2) the above trespasses represent only 20 percent of actual trespasses on State land, according to Department estimates.

A Potential $2.3 Million in Compensation Resulting from 1979 Trespass Damage May be Lost to the State

The State has the authority to bring civil actions against trespassers and to collect damages amounting to three times the damage caused by the trespass. As a result, trespass damage inflicted on State lands during 1979 represents a potential $2.3 million in compensation to the State.

A.R.S. §37-502(A) provides that:

> "Whoever commits any trespass upon state lands as defined by section 37-501 is also liable in a civil action brought in the name of the state in the county in which the trespass was committed, for three times the amount of the damage caused by the trespass, if the trespass was wilful, but for single damages only if casual or involuntary.

Thus, theoretically, the State could bring civil actions against those persons guilty of the 1979 trespasses listed on page 53 and collect up to $2,358,273 ($786,091 x 3) in compensating damages.

According to State Land Department records, during 1979 the Department did collect $45,980 in damages from trespassers. Therefore, it appears that collecting damages from trespassers is: 1) a viable option, and 2) a potentially significant revenue source.

In fact, it appears that the revenue-generating potential of civil actions against trespassers is significant enough to support an aggressive trespass program by the State Land Department.

It should be noted that the State Land Department has identified the trespass issue as one of its priority items. Since November 1979, the Department has taken steps to improve its procedures for the review and investigation of trespass cases. The Department should be commended for its efforts and encouraged to continue improving its trespass program.

Further, the State Land Department in its 1980-81 budget proposal requested additional personnel and equipment at a cost of $39,360. However, the Department's 1980-81 budget, as approved by the Legislature, did not make provision for the request.

CONCLUSION

The State Land Department has not been given specific statutory responsibility to identify and resolve instances of trespass upon State lands nor has it been provided with adequate resources to do so. As a result, during 1979 at least $786,000 in damage was inflicted on State lands by trespassers and a related $2.3 million in compensation may be lost to the State.

RECOMMENDATIONS

It is recommended that:

- The Arizona Revised Statutes be amended to require that the State Land Department identify and resolve instances of trespass on State lands.
- The Department be provided with staffing and resources commensurate with that additional responsibility.
- The Department develop and adopt formal procedures to review, investigate and monitor trespass activity promptly.
- The Department contact local law enforcement agencies and offer training courses regarding trespass on State lands.
- The Department contact Arizona's communications media regarding public service announcements dealing with trespass on State lands.

Bureau of Land Management

Range Betterment Fund

The Bureau of Land Management administers a Range Betterment Fund. This Fund derives its revenues from grazing lease fees. Of the grazing fees collected, 25 percent goes directly to the grazing district in which it was collected, 25 percent goes into the Range Betterment Fund and is distributed at the discretion of the Secretary of the Interior and 50 percent goes to school districts, the U.S. Treasury or to a particular county.

In fiscal year 1978-79, the Bureau of Land Management in Arizona spent $635,974 from the Range Betterment Fund on improvements of which $516,711 went to livestock management. The $635,974 is the sum of $251,135 allocated directly to the grazing district and $384,839 in discretionary funds distributed by the Secretary of Interior. Table 17 indicates the Bureau of Land Management expenditures on livestock management in Arizona during 1978-79.

TABLE 17

BUREAU OF LAND MANAGEMENT EXPENDITURES FOR LIVESTOCK MANAGEMENT IN ARIZONA DURING FISCAL YEAR 1978-79

Type of Improvement*	Amount of Expenditure
Studies and research	$ 1,335
Environmental analysis	41,734
Use adjustment	1,474
Project survey	25,975
Vegetative manipulation	265
Water facilities	304,660
Fences	47,612
Management facilities	1,478
Maintenance:	
Land & vegetation	3,950
Water facilities	72,056
Fences, enclosures	14,903
Management facilities	1,269
Total	$516,711

* See Appendix IX for type of improvement description.

Grazing improvements may be separated into two major categories as follows:

1. Improvements made directly to the land such as vegetative manipulation and control of erosion.

2. Improvements placed on the lands such as fences, water and stock ponds.

It should be noted that the State Land Department does not have the funding to improve grazing land nor does it place improvements on State lands for use by the rancher. The Bureau of Land Management does provide improvements directly to the land and will pay for all or a portion of the cost of improvements placed on lands for use by the rancher.

Classification and
Appraisal Fund

A.R.S. §37-107 states:

> "The classification and appraisal fees provided for in §37-108 are appropriated for the use and benefit of the state land department. Such fees shall be paid into the state treasury as other state funds and claims shall be drawn in the manner provided by law, approved by the department of administration division of finance and paid by the state treasurer, when in proper form. The amount of twenty-five thousand dollars of the monies derived from classification and appraisal fees shall not be subject to the provisions of §35-190. All such monies in excess of twenty-five thousand dollars shall revert to the general fund."

A.R.S. §37-108 lists the fees that shall be charged by the State Land Department. These fees include:

Filing bonds,

Filing applications for leases,

Filing applications for use permits,

Filing applications for assignment of leases,

Issuance of land patent, and

Purchase of maps, data processing outputs or copies of other records of the Department.

Table 18 illustrates the expenditures made from the classification and appraisal fund for fiscal years 1977-78, 1978-79 and 1979-80 (through May 31, 1980).

TABLE 18

EXPENDITURES FROM THE CLASSIFICATION AND APPRAISAL FUND FOR FISCAL YEARS 1977-78, 1978-79 AND 1979-80 (THROUGH MAY 31, 1980)

Type by Expenditures	Fiscal Year 1977-78	Fiscal Year 1978-79	Fiscal Year 1979-80*
Office furniture and equipment	$34,081	$ 70,159	$ 4,259
Publication of notices	27,581	33,557	30,332
Management consulting and appraisal by private companies		24,750	6,065
Management consulting by other State agencies		18,480	11,760
Aerial photographs	5,124	14,279	200
Report preparation		8,089	
Terminal leave pay		6,366	
Deposits on postage meter	2,000	6,000	
Travel expenses	1,275	4,255	2,785
Legal expenses	1,587	2,828	20,408
Conference registration and training expenses		1,862	1,358
Payroll and personnel-related	2,955	1,717	10,022
Revolving fund	1,000	1,000	1,000
Maps	853	541	52
Other	1,770	15,156	8,025
	$78,226	$209,039	$96,266

* Through May 31, 1980

Royalty Rate for Production of Oil or Gas

A.R.S. §27-555(B) states:

> "The noncompetitive leases shall provide for the payment by the lessee of a royalty of twelve and one-half percent of the market value of all oil, gas and other hydrocarbons produced, saved, sold and removed from the lands at the well as of the time of sale or removal from the lands, as the department may elect."

Currently there is no production of oil or gas on Arizona lands. Therefore, the State Land Department currently receives no such royalty payments from its lessees. If production were to be initiated, the State would receive 12 1/2 percent of all production as royalty payments.

In a survey conducted by the Office of the Auditor General, it was determined that, as of January 31, 1980, there were 27 states which leased state lands for production of oil or gas. The highest royalty rate for production was 25 percent (Texas) and the lowest royalty rate was 12 percent (Alaska). Table 19 illustrates the royalty rates for production of oil and gas on state lands. The states are listed in order from highest royalty rate to lowest royalty rate.

TABLE 19

ROYALTY RATES FOR PRODUCTION
OF OIL OR GAS ON FEDERAL AND STATE LANDS
(as of February 29, 1980)

Owner or Trustee*	Royalty Rate Percentage	Royalty Fees Collected F/Y 1978-79
Texas	25	$200,000,000
Louisiana	22	286,000,000
Oklahoma	19	20,000,000
North Carolina	17	N/R
South Dakota	17	1,740,000
California	16 2/3 - 50***	30,111,000
Florida	16 2/3	2,080,000
North Dakota	16 2/3	1,000,000
Tennessee	15	23
Alabama	13 - 25***	500,000
Federal lands**	12 1/2%-30%***	
Montana	12 1/2 - 25***	2,982,000
Michigan	12 1/2 - 19***	N/R
New Mexico	12 1/2 - 17***	107,360,000
Ohio	12 1/2 - 16***	N/R
ARIZONA	12 1/2****	-0-
Arkansas	12 1/2	171,000
Colorado	12 1/2	5,846,000
Idaho	12 1/2	N/R
Mississippi	12 1/2	N/R
Nebraska	12 1/2	318,000
New York	12 1/2	231,000
Oregon	12 1/2	N/R
Pennsylvania	12 1/2	1,332,000
Utah	12 1/2	8,500,000
Washington	12 1/2	N/R
West Virginia	12 1/2	N/R
Wyoming	12 1/2	14,348,000
Alaska	12	3,283,000

* Listed in order from highest royalty rate to lowest royalty rate.

** Lands administered by the Bureau of Indian Affairs and the Bureau of Land Management.

*** Royalty rate is dependent on location. Lands in close proximity to known deposits obtain a higher royalty rate.

**** Currently receives no royalty from oil or gas leases.

N/R No response.

Bruce Babbitt
Governor

Arizona
State Land Department
1624 WEST ADAMS
PHOENIX, ARIZONA 85007

Joe T. Fallini
Commissioner

August 27, 1980

Mr. Douglas R. Norton, Auditor General
Legislative Services Wing - Suite 200
State Capitol
Phoenix, Arizona 85007

Re: Performance Audit of the
State Land Department

Dear Mr. Norton:

The following comments are offered on the Performance Audit of the State Land Department in response to your request of August 22, 1980:

Finding I:

The State Land Department agrees with the conclusion and recommendations in Finding I. Consideration should be given by the Legislature to update the mineral royalty rate which has not been adjusted since 1941. Legislation similar to that proposed in Senate Bill 1294, introduced in 1979, would provide for assessment of royalty rates on gross rather than net value. Such legislation, if enacted, would provide for true value returns to the trust, simplify and reduce paper work for the mining companies and the State Land Department, and would provide for more equitable payment of royalties among mining companies.

Finding II:

The State Land Department agrees that statutory and administrative changes are needed to insure proper payment of mineral royalties. We believe that statutory changes should be made before the Land Department undertakes a revision of the rules and regulations so that rules and regulations are clearly within the intent of the law and discretionary authority given to the Land Department by the Legislature.

The Department is increasing its scrutiny over mineral leases with particular emphasis on reporting of revenues from copper leases. The Department has recently contracted with a major big-eight accounting firm to review accuracy of reporting by copper lessees.

Finding III:

The State Land Department agrees that the grazing lease rate charged by Arizona is significantly lower than that charged by the

Bureau of Land Management, nine other western states and private landowners.

Consideration should be given by the Legislature to the adoption of the grazing rate formula established by the Congress of the United States in the Rangeland Improvement Act of 1978. The formula was adopted by Congress after many years of study of the grazing fee issue, numerous public meetings and contacts with livestock operators in the western states.

Finding IV:

The State Land Department agrees with the conclusion and recommendations in Finding IV. Destruction of resources and loss of revenues to the trust from illegal activities presents one of the most serious problems facing the Land Department. The trespass law needs to be strengthened and the Land Department provided adequate resources to deter illegal activities. Aggressive action, as pointed out in the audit report, is needed to resolve the backlog of trespass cases as well as the cases being reported. The Land Department has made a concerted effort during the past year to deter abuses of state trust lands with the limited manpower available. From July 1, 1979 to August 15, 1980, $328,396.00 has been collected for grazing and mineral trespasses, illegal dumping, theft of fuelwood and other unauthorized uses. In addition, as of August 15, 1980, outstanding accounts receivable (billings mailed) for trespass activities amount to $214,300.00.

The State Land Department agrees to the recommendations that the Department develop procedures to review, investigate and monitor trespass, contact local law enforcement agencies for training, and to contact the media regarding public service announcements regarding trespass. Some progress has been made to implement these recommendations, which include: (1) the development of a computer program to document and track all trespass cases, (2) several county law enforcement agencies have been contacted and provided with maps of state land status, statutes on trespass and information on trespass problems. As a result of these contacts, about ten trespass cases have been resolved.

We believe the audit report accurately reflects the legislative and administrative changes needed to insure compliance with the provisions of the Enabling Act and the Arizona Constitution.

The audit team is commended for their objective report.

Sincerely,

Joe T. Fallini

Joe T. Fallini
Commissioner

JTF:rm

APPENDIX I

STATE SURVEY RESULTS

LEASING POLICIES REGARDING THE EXTRACTION OF METALLIFEROUS AND NONMETALLIFEROUS MINERALS

STATE SURVEY RESULTS

LEASING POLICIES REGARDING THE EXTRACTION
OF METALLIFEROUS AND NONMETALLIFEROUS MINERALS

State	Minerals Extracted From State Lands		Royalties Collected		Metalliferous Minerals Extracted						Nonmetalliferous Minerals Extracted			FY 78-79 Mineral Revenues	Royalty Fee
	Yes	No	Yes	No	Copper	Silver	Gold	Zinc	Iron	Moly*	Sand & Gravel	Coal	Other		
Alabama	X		X								X	X	Shell	$ 500,000	5 - 7 1/2 - 10%
Alaska	X		X									X		89,000	12% of revenue
ARIZONA	X		X		X	X	X			X	X			3,403,929	5% of net value
Arkansas	X		X								X	X		N/R	N/R
California	X		X						X		X		Trona, Talc, Shell	259,000	Not less than 10% of net revenue
Colorado	X		X								X	X	Scoria, Clay, Limestone	3,800,000	Varied
Connecticut		X													
Delaware		X													
Florida	X		X										Limerock	40,000	
Georgia		X													
Hawaii		X													
Idaho	X		X			X	X	X			X		Clay, Phosphate	99,460	Sliding scale of 25¢ per ton to 10% of net revenue
Illinois		X													
Indiana		X													
Iowa		X													
Kansas		X													
Kentucky	X		X									X		N/R	N/R
Louisiana	X		X									X	Salt, Sulfur	2,700,000	Varied
Maine	X		X		X			X						N/R	Negotiated
Maryland		X													
Massachusetts		X													
Michigan	X		X		X				X		X		Limestone, Dolomite	59,500	3 - 6% sliding scale on gross
Minnesota	X		X						X					1,966,000	60¢/ton
Mississippi		X													
Missouri		X													
Montana	X		X				X					X		1,040,000	5% of gross

N/R = No Response

* Molybdenum

State	Minerals Extracted From State Lands		Royalties Collected		Metalliferous Minerals Extracted						Nonmetalliferous Minerals Extracted			FY 78-79 Mineral Revenues	Royalty Fee
	Yes	No	Yes	No	Copper	Silver	Gold	Zinc	Iron	Moly*	Sand & Gravel	Coal	Other		
Nebraska	X		X										Uranium	$ 1,510	20¢/cubic yd. removed
Nevada		X													
New Hampshire		X													
New Jersey		X													
New Mexico	X		X								X	X	Uranium, Salt, Potash	2,475,000	Varied
New York	X		X								X			1,000,000	Varied
North Carolina	X		X										Phosphate	30,000	12 1/2 % of marketable phosphate
North Dakota	X		X									X		5,000,000	12 1/2%
Ohio	X		X								X		Salt	300,000	Varied
Oklahoma	X		X									X		-0-	7 1/2%
Oregon		X													
Pennsylvania	X		X								X	X	Limestone, Shale, Fieldstone	317,000	15¢ to $4/ton
Rhode Island		X													
South Carolina		X													
South Dakota	X		X								X			60,000	5% of market value
Tennessee	X		X					X				X		133,000	5% of gross
Texas	X		X			X	X			X		X	Sulfur, Uranium, Thorium	6,450,267	6 1/4% of gross
Utah	X		X		X	X	X	X	X	X		X		1,000,000	4% of net revenue
Vermont	X		N/R								X			N/R	N/R
Virginia		X													
Washington	X		X		X	X	X							N/R	4% net minimum plus negotiated amount
West Virginia	X		X									X		2,000	6 to 8%
Wisconsin		X													
Wyoming	X		X									X	Uranium, Bentonite	10,650,000	Varied

N/R = No Response

* Molybdenum

APPENDIX II

COMPARISONS OF MAJOR COPPER PRODUCERS ON STATE-LEASED LANDS

APPENDIX II

COMPARISONS OF MAJOR COPPER PRODUCERS
ON STATE-LEASED LANDS*

Year	Company	Content of Ore	Tons	Gross Value	Royalty	Gross Per Ton	Cost Per Ton	Net Per Ton	Royalty Per Ton
1973	A	.005616	7,597,700	$ 45,019,563	$ 1,212,383	$5.93	$2.73	$3.19	$.16
	B	.007944	3,851,743	34,549,826	1,194,330	8.97	2.77	6.20	.31
	C	.005129	11,143,524	60,202,926	1,762,834	5.40	2.24	3.16	.16
			22,592,967	139,772,315	4,169,547				.18**
1974	A	.005584	6,206,300	47,277,828	1,264,834	7.62	3.54	4.08	.20
	B	.008366	4,647,133	56,017,499	1,964,096	12.05	3.60	8.45	.42
	C	.005525	6,763,588	50,194,791	1,503,968	7.42	2.97	4.45	.22
			17,617,021	153,490,118	4,732,898				.27**
1975	A	.005910	4,728,300	33,175,486	553,713	7.02	4.67	2.34	.11
	B	.007222	3,173,980	28,657,285	948,147	9.03	3.05	5.97	.30
	C	.004924	6,717,823	35,012,107	692,742	5.21	3.15	2.06	.10
			14,620,103	96,844,878	2,194,602				.15**
1976	A	.006022	5,907,200	45,258,115	808,343	7.66	4.92	2.74	.14
	B	.007638	3,433,205	33,469,311	1,002,617	9.75	3.91	5.84	.29
	C	.005702	7,350,328	48,868,333	1,010,347	6.65	3.90	2.75	.14
			16,690,733	127,595,759	2,821,307				.17**
1977	A	.005724	4,461,700	31,493,281	441,551	7.06	5.08	1.98	.10
	B	.007381	3,865,796	35,208,147	871,693	9.11	4.60	4.51	.23
	C	.005401	5,332,419	33,854,961	511,378	6.35	4.43	1.92	.10
			13,659,915	100,556,389	1,824,622				.13**
1978	A	.005900	7,317,200	50,018,642	694,246	6.84	4.94	1.90	.09
	B	.006833	3,642,362	30,538,256	783,030	8.38	4.08	4.30	.21
			10,959,562	80,556,898	1,477,276				.13**
1979	A	.006877	4,789,000	62,792,437	1,742,343	13.11	5.84	7.28	.36
	B	.007634	376,732	5,512,469	157,773	14.63	6.26	8.38	.42
	C	.004980	1,402,483	16,318,757	406,049	11.64	5.85	5.79	.29
	D	.005560	8,960,100	129,251,534	3,853,949	14.43	5.82	8.60	.43
			15,528,315	213,875,197	6,160,114				.40**
Total			111,668,616	$912,691,554	$23,380,366				$.21**
	Average for 7 years		15,952,659						

* Source - State Land Department

** Weighted average (Royalty ÷ tons)

APPENDIX III

STATE LAND MINERAL ROYALTY RECONCILIATION
1977 & 1978

State Land Mineral Royalty Reconciliation
1977 & 1978

	1977		1978	
Dry tons ore treated		(1) 16,889,690		(1) 19,624,815
Tons ore mined	(2) 17,000,047		(2) 19,638,032	
Mine ore used as flux	(110,357)		(13,217)	
Dry tons ore treated (milled)		16,889,690		19,624,215
Smelter payable copper pounds		(1) 193,956,782		(1) 212,988,197
Adjustment for difference in recovery rates		2,291,730		
Adjusted payable copper pounds		196,248,512		
Smelter payable copper tons		98,124		106,494
Tons of copper per 10-K	(2) 111,105		(2) 117,392	
Tons of copper in reprocessed slag	(12,748)		(11,389)	
Tons of copper in mine ore flux	(792)		(92)	
Rounding in calculation of state copper U.S. Mill Production Report	(185)		(25)	
Smelter losses on adjustments	744		608	
Smelter payable copper tons		98,124		106,494
Molybdenite pounds		(1) 5,590,860		(1) 4,109,405
Adjustment for computation of errors		(161,028)		
Adjustment for reported contained molybdenum instead of molybdenite				1,800,301
Adjusted molybdenite pounds		5,429,832		5,909,706
Molybdenite tons		2,715		2,955
Tons molybdenum sulfide per 10-K		(2) 2,715		(2) 2,955

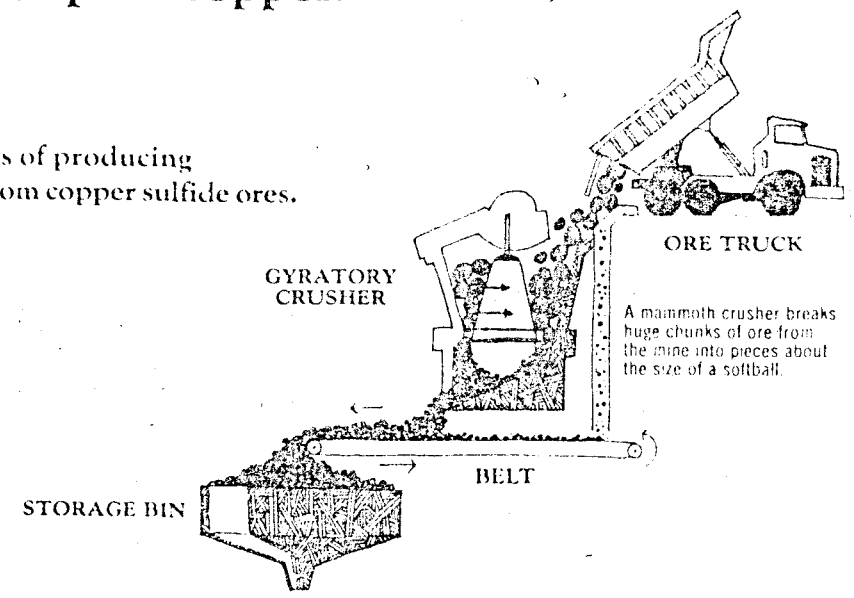
(1) As reported in provisional report to State Land Department
(2) As reported in...10-K report

APPENDIX IV

PROCESSING LOW-GRADE ORE INTO PURE COPPER

Processing 0.6% low grade ore into 99.99% pure copper.

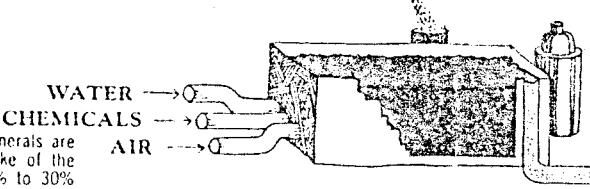
A process of producing copper from copper sulfide ores.



A mammoth crusher breaks huge chunks of ore from the mine into pieces about the size of a softball.

. . . Two tons of waste rock must be discarded to obtain one ton of ore at the crusher.

In additional stages involving massive crushing and grinding machines these pieces of ore are progressively reduced to a powdery sludge

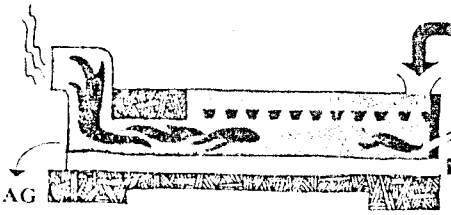


The sludge is diluted with water, small amounts of chemicals and frothing oil, and piped to flotation separators. There the chemicals selectively coat the tiny particles of copper compounds but not those of waste rock.

Air is blown into the tank, forming an oily froth of bubbles carrying the copper minerals. These overflow into the troughs beside the tank. The concentrated copper minerals are filtered out, becoming a cake of the powder containing from 15% to 30% copper.

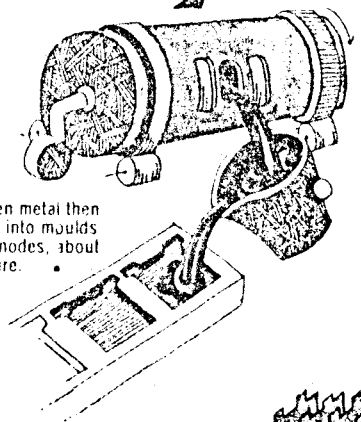
. . . Flotation removes approximately 45 pounds of copper concentrate, and discards about 1,955 pounds of waste in the form of tailings.

Sulfur dioxide and other impurities are vented to an acid plant, where the gas is scrubbed dryed, cooled and converted to sulfuric acid



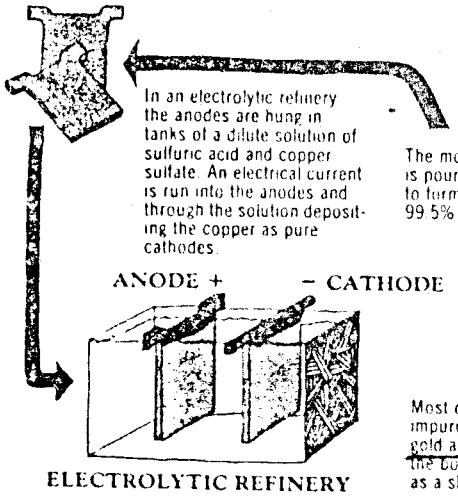
In a roaring reverberatory furnace, the concentrate is melted and many of the impurities are removed, yielding molten "matte" containing variously from 35% to 50% copper, 25% sulfur and the balance iron.

. . . In the smelter the 45 pounds of copper concentrate are reduced to approximately 10 pounds of copper. The rest is discarded in the form of slag.



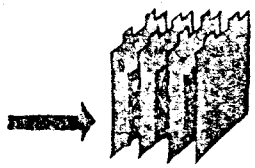
In converter and anode furnaces the matte is still further purified for removal of iron and sulfur to produce first "blister" and then "fire refined" copper.

The molten metal then is poured into moulds to form anodes, about 99.5% pure.



In an electrolytic refinery the anodes are hung in tanks of a dilute solution of sulfuric acid and copper sulfate. An electrical current is run into the anodes and through the solution depositing the copper as pure cathodes.

Most of the remaining impurities (including gold and silver) fall to the bottom of the tank as a sludge.



The finished cathodes are in many cases 99.99% copper, pure enough for the most exacting requirements.

Note: Figures used are statewide industry averages and will vary at each operation.

APPENDIX V

ARIZONA LEGISLATIVE COUNCIL MEMORANDUM
MARCH 28, 1980

MEMO

March 28, 1980

TO: Douglas R. Norton, Auditor General

FROM: Arizona Legislative Council

RE: Request for Research and Statutory Interpretation (O-80-13)

This is in response to a request submitted on your behalf by Gerald A. Silva in a memo dated March 17, 1980. No input was received from the Attorney General concerning this request.

FACT SITUATION:

A.R.S. section 27-234, subsection B states:

> Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. The net value shall be deemed to be the gross value after processing, where processing is necessary for commercial use, less the actual cost of transportation from the place of production to the place of processing, less costs of processing and taxes levied and paid upon the production thereof. . .

A.R.S. section 27-235, subsection C, paragraph 6 states:

> Termination of the lease by the commissioner upon written notice specifically setting forth the default for which forfeiture is declared, and preserving the right to cure the default within a stated period of not less than thirty days.

In the processing of the copper ore, one of the mines on state land had been accumulating a slag pile for a number of years. The slag, which results from the smelting process, is set aside in piles adjacent to the smelter but some distance from state land. The slag contains low concentrations of copper which was originally extracted from:

1) state lands,

2) private lands owned by the company with the smelter accumulating the slag,

3) other mines which send their ore to the smelter to be processed.

In recent years the company has reprocessed the slag and derived more copper in salable concentrations.

In past reports filed with the State Land Department this company has deducted the costs of reprocessing the slag but has not paid the state additional royalties on the sale of the slag.

QUESTIONS PRESENTED:

1. (a) Should the mine pay the State Land Department (SLD) for costs deducted in the reprocessing of the slag or (b) should the state be paid royalties on the copper derived from the slag which can be traced to ore extracted from state land?

2. Since there may be a difference of amounts derived in 1(a) or 1(b), can the Land Department pick the method of determining additional royalties due?

3. Is there any limitation on the number of years SLD can go back to determine royalties on reprocessed slag (i.e., 5, 10, 15, 20, 25 years)? Would the fact that a final report had been filed with SLD have any bearing on royalties due the state (see Request for Research and Statutory Interpretation 0-80-7 and SLD regulation R12-5-706)?

4. Would the inclusion of costs for reprocessing slag on previous reports or nonpayment of royalties on reprocessed slag put the mine in danger of having its least terminated?

ANSWERS:

1. (a) No.

(b) The lessee should pay to the state royalties on copper derived from the slag which can be traced to ore extracted from leased state land by the lessee.

The mineral lease enclosed with Request for Research and Statutory Interpretation 0-80-12 is assumed to be the usual form of lease involved here, and this request is answered on the basis of that lease. This form confers on the lessee the right to "extract and ship minerals, mineral compounds and mineral aggregates" from the claim, and the obligation to "pay as royalty 5% of the net value of the minerals produced from the leased premises." Other provisions provide a formula for calculating net value of the minerals produced, by deducting from the "gross value after processing" the costs of transportation and processing.

A lease of lands constitutes a contract between the state and the lessee which vitally affects the public interest and should be construed liberally in favor of the public. 2 American Law of Mining, section 12.5; 73 C.J.S. Public

Lands 111(a). Here, however, no principles of statutory construction need be applied. The terms of the statute and of the lease as to royalty payable are clear and unambiguous and need no construction.

Certain copper concentrates have been derived in the smelting process, on which royalties have been paid. Certain other copper concentrates have been derived by reprocessing the slag which resulted from the smelting process. There is no significance to be attached to the fact that the second processing took place some time after the first, or that new methods of processing made the second processing possible, or that a change in the market makes the second processing profitable. The lease contains no limitations or conditions with respect to the time when, or the process by which, salable minerals are produced.

In Haynes v. Eagle-Picher Co., 295 F.2d 761 (1961), cert. den. 369 U.S. 828, 82 S. Ct. 846 (1962), a mining lease required payment of a royalty of five per cent "of the market value at the place mined or produced of all oil, gas, asphaltum, lead, zinc and all other minerals or substances whatever, which may be mined or removed." The Court stated that an open market existed continuously and for some time prior to the original lease for zinc and lead concentrates and that royalties based upon the market value of the zinc and lead concentrates were paid by the lessee as full royalty payment; that lessee later, utilizing advanced processing techniques, began saving commercially sulphur, cadmium and germanium out of the residue of the concentrates, and that lessee paid no royalty on these newly discovered mineral values. It was held that the lessee was liable for royalty payments on the sulphur, cadmium and germanium thus produced, the Court stating at p. 764:

> . . . we turn to the interpretation of the covenants contained therein, and particularly those words which obligate the lessees to pay five per cent "of the market value at the place mined or produced of all oil, gas, asphaltum, lead, zinc and all other minerals or substances whatever, which may be mined or removed." Given a reasonable construction, we think this rather conventional language was intended to obligate the lessees to pay the lessors a five per cent royalty on all minerals produced and sold. It is undisputed that sulphur, cadmium and germanium are minerals and, while they may not have had any value at the place "mined," they had a very definite value at the place "produced" after having been mined and removed. The disjunctive reference to the term "produced" in the lease admits, we think, of no other interpretation than that the parties contemplated the possibility that the production of minerals might well be accomplished at places and times other than those of the actual mining operations. It is common knowledge that minerals are not separated from the earth in pure form and that, except in rare instances, some processing is necessary to render them marketable. Indeed, it is admitted in our case that processing, to the extent of reducing the crude ore to concentrate form, has always been necessary before any market value at all is attained. The market

value so attained was based entirely on the zinc and lead content of the concentrates and the payment of royalty out of the proceeds of the sale of these concentrates did not compensate the landowner for the additional minerals they contained. When further processing resulted in the saving of sulphur, cadmium and germanium from the residue of the concentrates, these minerals acquired a market value of their own. The conclusion must follow, we think, that having been "produced" and have acquired an ascertainable value, the sulphur, cadmium and germanium were covered by the terms of the lease. (Emphasis supplied.)

The Court also pointed out that proof of custom cannot modify clear and unambiguous language as to royalties.

The present case is even stronger, the same kind of mineral having been produced by different or successive processing.

Apparently there is no serious problem of identification of the source of the slag since the lessee was able to calculate reprocessing costs.

The fact that the slag is set aside in piles adjacent to the smelter but some distance from state land does not influence this interpretation. Title to ore extracted pursuant to the lease is personal property vesting in the lessee as soon as it is mined and removed from its original place, subject to the royalty rights of the lessor. 58 C.J.S. Mines and Minerals, section 177 and cases there cited.

In addition, the lease at paragraph 7 specifically creates a lien upon all minerals obtained from the land leased, as security for payment of monies owed the state.

2. The Land Department cannot elect to receive royalties due or to receive the amount the lessee deducted for costs in reprocessing the slag. The leasing agency has no authority to release a lessee from liability for royalty deficiencies. State v. Northwest Magnesite Co., 28 Wash. 2d 1, 182 P.2d 643 (1947). The Land Department has administrative authority to implement the statutes but no authority to modify the terms of the lease which are prescribed by statute. See Op. Atty. Gen. No. 59-97 (1959), holding that the Land Commissioner has no authority to establish a value of ore in the pit without using the formula provided by Arizona Revised Statutes section 27-234.

3. There is no statute limiting the number of years the Land Department can go back to determine royalties on reprocessed slag. The statute of limitations does not run against the state. Arizona Revised Statutes section 12-510. Nor are laches and estoppel defenses available against the state. Kerby v. State ex rel. Frohmiller, 62 Ariz. 294, 157 P.2d 698 (1945).

4. Nonpayment of royalties on the reprocessed slag is not a default for which forfeiture of the lease can be declared. As indicated in the response to Request 0-80-7, there is no express statutory provision relating to the due

date of royalty payments. As to the lease itself, the lease form used as the basis for this response provides:

> 3. So that the State may be properly advised of the removal of ores and mineral substances from the lands involved in this lease, the lessee agrees to file with the State Land Commissioner, within twenty (20) days after the removal of any such ores or mineral substances, an authenticated statement of the gross values found and accounted for by the smelter, mint, or other place of customs treatment and sale.
>
> 4. The lessee agrees to pay all royalties under this lease to the State Land Comissioner within twenty (20) days after the close of each month within which the minerals were extracted; such payments will be accompanied by a sworn statement on forms furnished by the Department.
>
> 6. The lessee shall keep an accurate account of said operations showing the amount of mineral mined or extracted and all mineral shipped, smelted, used, or disposed of, the cost of such operations, and the gross value of the output of the minerals at the mine. The State Land Commissioner and other proper representatives of the Department shall have the right at all times during the existence of this lease, and for six months thereafter, to make such reasonable examinations of the papers and books of account of the said lessee and of the mines as may be necessary to obtain all information desired.

Both paragraphs 3 and 4 of the lease require filing of information and payment of royalties within a certain time after extraction and removal of the minerals, presumably a time period chosen to allow for the lag between extraction and processing. The only provision relating to "mineral used or disposed of", which would include copper derived by reprocessing the slag and used or sold, is found in paragraph 6 requiring an accurate account of operations to be kept. Royalty payments on copper derived from later reprocessing would have to be calculated from these accounts when the cost of such reprocessing has been ascertained through the filing of monthly reports (A.C.R.R. R12-5-706).

The fact that no specific time for payment is provided does not mean that payment need not be made. A reasonable time after ascertainment of the amount of the royalty would be implied. After that, the agency could take whatever steps are necessary to enforce the lien provided by the lease at paragraph 7.

Inclusion of costs for reprocessing slag in previous reports would also not be grounds for declaration of forfeiture of the lease. Inclusion of such costs would seem to be a literal compliance with paragraph 6 of the lease, quoted above, showing all costs of operation. At what point costs should be deducted from gross value to reach net value would have to be determined by the lessor and lessee on the basis of these reports and any other information required by the Land Department; no misstatement or misrepresentation seems to be involved.

cc: Gerald A. Silva
Performance Audit Manager

APPENDIX VI

ARIZONA LEGISLATIVE COUNCIL MEMORANDUM
FEBRUARY 22, 1980

ARIZONA LEGISLATIVE COUNCIL

MEMO

February 22, 1980

TO: Douglas R. Norton, Auditor General

FROM: Arizona Legislative Council

RE: Request for Research and Statutory Interpretation (O-80-7)

This is in response to a request submitted on your behalf by Gerald A. Silva in a memo dated February 8, 1980. No input was received from the Attorney General concerning this request.

FACT SITUATION:

Arizona Revised Statutes section 27-234, subsection B states:

> Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. The net value shall be deemed to be the gross value after processing, where processing is necessary for commercial use, less the actual cost of transportation from the place of production to the place of processing, less costs of processing and taxes levied and paid upon the production thereof. . .

Arizona Revised Statutes section 27-235, subsection C, paragraph 6 states:

> Termination of the lease by the commissioner upon written notice specifically setting forth the default for which forfeiture is declared, and preserving the right to cure the default with a stated period of not less than thirty days.

QUESTIONS PRESENTED:

* * *

2. The amount of royalty paid to the State Land Department is determined through the filing of a preliminary report and later a final adjusted report. The preliminary reports are usually received one month after the ore is mined. Final adjusted reports arrive from three to eighteen months after the preliminary report. One mining company has not filed final adjusted reports for the last nine years. Adjustments could favor the mines or the State Land Department.

a. Is there any statute of limitations that affects the filing of the final adjusted reports on mineral royalties?

b. What incentives are available in the statutes and rules and regulations to encourage the mining companies to file the final adjusted reports more promptly?

c. If the incentives in (b) are not sufficient, can the State Land Department establish such incentives in their rules and regulations or must the statutes be amended? Examples of such incentives are deadline dates for reports, penalties or interest on late filings, fines, etc.

d. Would such delays in filing reports be just cause for termination of the lease as stated at Arizona Revised Statutes section 27-235, subsection C, paragraph 6?

ANSWERS:

1. The full text of section 27-234, subsection B, Arizona Revised Statutes states:

> B. Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. The net value shall be deemed to be the gross value after processing, where processing is necessary for commercial use, less the actual cost of transportation from the place of production to the place of processing, less costs of processing and taxes levied and paid upon the production thereof. In case of minerals not processed for commercial use, the net value shall be the gross proceeds, or gross value, at the place of sale or use, less the actual cost of transportation from the place of production to the place of sale or use, less taxes, if any, levied and paid upon the production thereof.

The legislature in the above statute sets forth clearly and explicitly the only formula to be used in establishing the net value of state land minerals.

The royalties inuring to the benefit of the state are determined from this base net value.

"The statutory formula is a mandatory guide which limits the discretion of the state land commissioner." Op. Atty. Gen. No. 59-9 (1959). (Emphasis supplied.)

Thus the only items permitted to be subtracted from the gross value are:

1. Cost of transportation from place of production to place of processing (if processed) or place of sale or use.

2. Cost, if any, of processing.

3. Amount of taxes levied and paid upon production.

* * *

2(a). The Arizona statutes and the rules and regulations of the state land department do not provide for an adjusted report.

Arizona Administrative Rules and Regulations R 12-5-706 provides for only a monthly production report (emphasis added):

> B. Monthly production report. A monthly report of production shall be submitted by the lessee of each mineral claim within 15 days after the end of the month in which production is first had and before the 15th of each succeeding month for the month immediately preceding, unless otherwise ordered by the Commissioner. Any negative report subsequent to the initial production report shall be submitted unless waived by the Commissioner. The report shall be in such form as the Commissioner may prescribe and shall contain such information as the Commissioner may require, including, but not limited to, information regarding amounts of mineral extracted, use, or sold, the costs of shipping and processing, and the monetary returns therefrom.

There are no statutory or regulatory provisions regarding the adjusted report and therefore no deadline for such a report. The deadline in the above regulation applies to the production report or preliminary report, as it is known by the department.

2(b). See discussion of (a), above.

2(c). Section 37-132, Arizona Revised Statutes, prescribes the powers of the state land commissioner:

> 37-132. Powers and duties
>
> A. The state land commissioner shall:
>
> 1. Exercise and perform all powers and duties vested in or imposed upon the state land department, and prescribe such rules and regulations as are necessary to discharge those duties.
>
> 2. Exercise the powers of surveyor-general.
>
> 3. Make long-range plans for the future use of state lands in cooperation with other state agencies and political subdivisions.
>
> 4. Classify and appraise all state lands, together with the improvements thereon, for the purpose of sale or lease. The state land commissioner may impose such conditions and covenants and make such reservations in the sale of state lands as he deems to be in the best interest of the state of Arizona. Sales to governmental agencies for cash without public auction shall be made for a specific purpose and on condition of reversion to the state of Arizona when the lands cease to be put to the purpose for which they shall have been sold. The provisions of this paragraph shall be subject to hearing and judicial review procedures pursuant to section 37-134.

5. Have authority to lease for grazing, agricultural, homesite or other purposes, except commercial, all land owned or held in trust by the state.

6. Have authority to lease for commercial purposes and sell all land owned or held in trust by the state but any such lease for commercial purposes or any such sale shall first be approved by the board of appeals provided for by section 37-213.

7. Except as otherwise provided, determine all disputes, grievances or other questions pertaining to the administration of state lands.

Nowhere in Arizona statutes is there any express statutory provisions relating to the due date of royalty payments.

However, because state lands are held in trust for the benefit of the beneficiaries of that trust (the people of Arizona) in the absence of legislative action, the land commissioner probably can prescribe reasonable rules and regulations to assure that state lands are being administered in a manner beneficial to the state. There is no case law on this point.

The perimeters of this power, in the absence of any clear legislative direction, would have to be tested by the courts.

As the statutes do not require a deadline for the payment of royalties it is not absolutely clear whether the land department or land commissioner can require payment on a monthly basis. Less clear would be the authority to impose fines or other penalties for an adjusted report.

If the department requires or allows an adjusted report, due process requires that this be set forth in a regulation so that the procedure would be administered in an impartial and uniform manner to all lessees.

2(d). Section 27-234, subsection B, Arizona Revised Statutes, provides:

B. Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. (Emphasis added.)

Since the payment of a royalty is a required term of any mineral lease it would appear that the state land commissioner or land department could prescribe the time and methods of collecting the royalty and include such conditions as a term of the lease agreement, including a penalty clause for late filing of information necessary for determination of the royalty.

If included as a term of the lease, the failure to file the information as prescribed by the terms of the lease would be deemed a default for which the commissioner could terminate the lease pursuant to Arizona Revised Statutes section 27-235, subsection C, paragraph 6:

C. Every mineral lease of state lands shall provide for:

* * *

6. Termination of the lease by the commissioner upon written notice specifically setting forth the default for which forfeiture is declared, and preserving the right to cure the default within a stated period of not less than thirty days.

SUMMARY:

Article X, section 3, Constitution of Arizona, incorporates the provisions of the Enabling Act, relating to state mineral lands:

"Nothing herein or elsewhere in this article X contained, shall prevent:

* * *

2. The leasing of any said lands, in such manner as the Legislature may prescribe, whether or not also leased for grazing and agricultural purposes, for mineral purposes, other than for the exploration, development, and production of oil, gas and other hydrocarbon substances, for a term of twenty years or less, without advertisement, or. . . (emphasis added)

In transferring title to mineral lands to the state in the Enabling Act and the 1927[1] and 1936[2] amendments to it, Congress presumably viewed Arizona as a responsible sovereign capable of administering these lands and their resources to provide the greatest benefit to the beneficiaries of the trusts."[3]

There is only one statutory provision expressly relating to royalties from mineral leases, which only provides that there is a royalty and the amount:

27-234. Rent; royalty; termination of lease by lessee

* * *

B. Every mineral lease of state land shall provide for payment to the state by the lessee of a royalty of five per cent of the net value of the minerals produced from the claim. The net value shall be deemed to be the gross value after processing, where processing is necessary for commercial use, less the actual cost of transportation from the place of production to

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1 Act of Jan. 25, 1927, ch. 57, sec. 1, 44 Stat. 1026, Codified 43 U.S.C. Sec. 870 (1970). This Act is a general amendment applicable to the land grant states which were subject to an initial mineral reservation.

2 Act of June 5, 1936, ch. 517, 49 Stat. 1477.

3 Shiner, James. "State Mineral Leases on Arizona's School Lands." 15 Arizona Law Review 211 (1973), p. 222.

the place of processing, less costs of processing and taxes levied and paid upon the production thereof. In case of minerals not processed for commercial use, the net value shall be the gross proceeds, or gross value, at the place of sale or use, less the actual cost of transportation from the place of production to the place of sale or use, less taxes, if any, levied and paid upon the production thereof.

The statutory sections relating to state mineral leasing have been left substantially untouched since 1945. A comparison of Arizona statutes with those of other western states relating to the leasing of state mineral lands demonstrates a disparity as to how the interests of the state are protected. Seeming inadequacies which are notable in a comparison of our current statutory framework with the law of other states include:

There is no statute prescribing the date when royalty payments are due (compare with Texas and New Mexico prescribing payment and final accounting each month).

There is no statute providing for methods or procedures for determining gross value of ore produced (compare with Texas statutes which require payments to be accompanied by sworn affidavits showing gross value and market value of production, receipts, checks and memoranda of amounts produced).

There is no provision for challenging the lessee's determination of value (compare with Texas and New Mexico statutes authorizing a state agency to inspect lessee's books, accounts, records and contracts relating to production, transportation, selling and marketing of minerals).

There is no statutory provision authorizing the land commissioner or land department to promulgate rules and regulations to carry out the provisions of Title 27, chapter 2, article 3, Arizona Revised Statutes, relating to leasing of state mineral lands.

There is no statutory provision penalizing the lessee for late payment or providing methods to secure payment of a royalty (compare with Texas statute granting state a first lien on minerals produced to secure payment of unpaid royalty; New Mexico statute requiring lessee to furnish bond to secure royalty payment and providing that attempt to defraud state of royalty is a felony).

Since administrators work within the confines of the current Arizona statutory framework an author has aptly concluded that, "/o/nly the legislature has power to decide whether the existing royalty system of mineral leasing on trust lands is consistent with the degree of (federal) confidence placed in this state."[4]

RECOMMENDATION:

The state land commissioner or land department should promulgate regulations prescribing the time and method of filing an adjusted report and include this as a condition in every mineral lease.

The state legislature should evaluate existing statutes to determine whether the existing royalty system adequately protects the interests of the beneficiaries of the state land trust.

---

[4] Shiner, James. Ibid, p.222.

cc: Gerald A. Silva
Performance Audit Manager

APPENDIX VII

MONTHLY MINERAL LEASE REPORTING FORM REQUIRED
BY THE STATE LAND DEPARTMENT

APPENDIX VII

IMPORTANT INSTRUCTIONS

1. This form is to be used only for reporting estimates of mineral production and for preliminary royalty payments; use of this procedure by mineral lessees must be authorized in writing by the Commissioner, State Land Department.
2. This form is to be used in conjunction with "Special-Final" Form, for final royalty accounting and payment.
3. Do not submit supporting data with this form; submit only production and costs summary.
4. Lessee's records are subject to audit by the State Land Department.
5. This form must be notarized and submitted together with the preliminary royalty payment within thirty (30) days from the end of each month.

ARIZONA STATE LAND DEPARTMENT
400 Arizona State Office Building
Phoenix, Arizona 85007

PRELIMINARY ROYALTY PAYMENT AND
AFFIDAVIT OF ESTIMATE OF MINERAL PRODUCTION

Month of _____, 19____. Mineral Lease No. _____

STATE OF ARIZONA)
) SS
County of _____)

_____ being duly sworn on oath deposes and says:
Name of lessee or agent

That he is the Lessee or Lessee's authorized agent of record for the Arizona State Mineral Lease No. _____, and that during the month of _____, 19____, _____ (name types of minerals) was removed from said lease area in amounts and at values shown on the attached monthly summary of production (attach summary authorized by the Commissioner, State Land Department), and that no materials other than those shown on the attached summary or otherwise reported to the State Land Department were removed from said lease area during the above month.

That the attached monthly summary of production is made according to the lessee's normal operating procedure, and that the estimates made therefrom are accurate by industry standards.

That the:

1. Estimated gross value of material produced from State land is.. $_____
2. Estimated cost of processing said material is..... $_____
3. Estimated cost of transportation to place of processing is..... $_____
4. Estimated total of applicable taxes is..... $_____
5. Total of 2, 3, and 4 is..... $_____
6. Estimated net value (1 less 5) of said material is..... $_____
7. Estimated royalty (5% of 6 above) is..... $_____

That the estimated royalty (7 above) of $_____ is submitted herewith. (Final production report and payment is due within thirty (30) days after acquisition of necessary final data on the production for month of this report.)

CERTIFICATION:

I hereby certify under penalty of perjury, that the information contained herein is to the best of my knowledge and belief true correct and complete.

_____ _____
Signature Title

_____
Firm

Subscribed and sworn before me this _____ day of _____, 19____.

STATE OF ARIZONA)
) SS
County of _____)

My Commission expires:

_____ _____
Notary Public

Attachment "A" Production-Recovery Sheet

INSTRUCTIONS

1. This form is to be completed by Lessee in conjunction with both the Preliminary and Final Forms for royalty accounting and payment.

TO: ARIZONA STATE LAND DEPARTMENT
1624 W. Adams
Phoenix, Arizona 85007

Date _____

LESSEE _____

State Land Department Lease No.(s) _____

Production Month _____, 19_____

			ASSAYS			
1. MILL HEADS	DRY TONS	Cu %	Mo %	Ag. oz.	OTHER
Lessee					
State					
TOTAL					
2. CONCENTRATES - COPPER					
Lessee					
State					
TOTAL					
CONCENTRATES - COPPER-MOLY (where applicable)					
Lessee					
State					
TOTAL					
CONCENTRATES - MOLYBDENUM					
Lessee					
State					
TOTAL					

3. CONTENT - HEADS	COPPER POUNDS	MOLY POUNDS	oz Ag.	OTHER
Lessee				
State				
TOTAL				
COPPER CONCENTRATES				
Lessee				
State				
TOTAL				
COPPER - MOLY CONCENTRATES				
Lessee				
State				
TOTAL				
MOLYBDENUM CONCENTRATES				
Lessee				
State				
TOTAL				

4. VALUES IN CONCENTRATES' CONTENT - DOLLARS	COPPER $	MOLY $	SILVER $	OTHER $
Lessee				
State				
TOTAL				

GROSS TOTAL DOLLARS - ALL METALS

Lessee _____
State _____
TOTAL _____

PRICES USED: Copper _____
Moly _____
Silver _____
Other _____

CERTIFICATION:
I hereby certify under penalty of perjury, that the information contained herein is to the best of my knowledge and belief true, correct and complete.

_____ _____
Signature Title

APPENDIX VIII

ARIZONA LEGISLATIVE COUNCIL MEMORANDUM
MARCH 21, 1980

ARIZONA LEGISLATIVE COUNCIL

APPENDIX VIII

MEMO

March 21, 1980

TO: Douglas R. Norton
Auditor General

FROM: Arizona Legislative Council

RE: Request for Research and Statutory Interpretation (0-80-12)

This is in response to a request submitted on your behalf by Gerald A. Silva in a memo dated March 10, 1980. No input was received from the office of the attorney general concerning this request.

FACT SITUTATION:

Enclosure #1 states in pertinent part:

> 4. The lessee agrees to pay all royalties under this lease to the State Land Commissioner within twenty (20) days after the close of each month within which the minerals were extracted; such payments will be accompanied by a sworn statement on forms furnished by the Department. (Emphasis added.)

Enclosures #2 and #3 are copies of royalty payment support data supplied to the state land department from two mines, Co. 1 and Co. 2. Please note that enclosure #2 (Co. 1) consists of two state forms (2/3 and 3/3). Enclosure #3, on the other hand, consists of only one state form (2/3).

QUESTIONS PRESENTED:

1. Is Co. 2 in violation of its lease agreement by not using the forms furnished by the state land department?

2. Without the use of the Enclosure #2 (3/3) form, the state land department cannot determine the ounces of silver taken from state lands. For example, refer to the Enclosure #2 (3/3) form which provides for specifying by Mill Heads the Dry Tons Assays for Cu%, Mo%, Ag oz. and then refer to the Enclosure #3 (3/3) data which includes "Net sulfide copper - .642% and Molybdenite -- .03%." There is no reporting of silver assay per "dry tons ore treated." Can the state land department demand the inclusion of such information?

ANSWERS:

1. Yes.

2. Yes.

1. Not stated in the fact situation but presumed by us is the fact that the state land department is furnishing to Co. 2 the form marked 3/3 in Enclosure #2 and completed by Co. 1.

Enclosure #1 is the mineral lease. Reading the mineral lease as a whole, it is apparent that the state land department contemplated the need for reporting by the lessee as to the amount of minerals, ores and other substances removed from the leased lands to ensure proper payment of the royalties required. The lease provision quoted in question 1 clearly indicates that more than one form will be required. The language is plain and consequently requires no application of rules of construction. Had the department not intended reporting requirements, the lease would have provided only for payment of royalties or, at most, payment accompanied by a sworn statement.

The significance of furnishing forms is apparent. Furnishing forms for recording information results in more simple, consistent administration and record keeping. Further, requiring that certain forms be used ensures that specific information is provided. The example in your second question illustrates this point.

The lessee would be in violation of the lease terms if the lessee was not completing all of the forms provided by the department.

2. Another lease provision provides in part:

> 13. This lease is made and accepted subject to existing law and any laws hereafter enacted, also to the regulations relative to such leases heretofore or hereafter prescribed by the lessor; . . .

Currently specific records and reports are required of mineral lessees by the state land department's rules and regulations. A.C.R.R. R12-5-706 provides in pertinent part:

> A. Annual lease report. An annual report shall be submitted by the lessee of each mineral claim showing any and all work performed, improvements made, the cost thereof, and such other information as the Commissioner may require. The report . . . shall be in such form as the Commissioner may prescribe.
>
> B. Monthly production report. A monthly report of production shall be submitted by the lessee of each mineral claim . . . . The report shall be in such form as the Commissioner may prescribe and shall contain such information as the Commissioner may require, including, but not limited to, information regarding amounts of mineral extracted, use, or sold, the costs of shipping and processing, and the monetary returns therefrom.
>
> C. Records. Each lessee of a mineral claim shall make and keep appropriate books and records covering the mining, shipping,

processing and selling of mineral from the claim. The Commissioner or his representative shall have the right at all times during the existence of each lease of a mineral claim, and for six months thereafter, to make such reasonable examination of such books, records or other material as may be necessary to obtain information desired.

Under the cited lease provision the lessee is subject to current rules and regulations of the state land department, the lessor. The cited regulation is clearly stated. The state land commissioner may require that certain information is provided by the lessee in the monthly production report. In addition, the lessee is required to keep certain books and records, and the state land commissioner or a representative has the right to seek desired information by inspecting those books and records of the lessee. Further, a specific provision of the lease requires the lessee to keep an accurate account of the mining operation and authorizes inspection of the lessee's books of account by the commissioner and department representatives. The language of the lease provision and the regulation is nearly identical so the lease provision is not quoted here.

The statutes, the lease and the department's regulations do not restrict the type of information which the commissioner is authorized to obtain apart from the fact that the information must relate to the leased "mineral claim". (See A.C.R.R. R12-5-706, subsection C.)

A.C.R.R. R12-5-706, subsection B specifically permits the state land commissioner to require the lessee's monthly production report to include the general information specified. No exclusions are stated and that fact is emphasized by the use of the phrase "but not limited to".

A.C.R.R. R12-5-706, subsection C and the lease provision (number 6 on page 2 of the lease) indicate that the lessee must keep records covering certain aspects of the mineral claim and the commissioner is authorized to inspect those records to obtain desired information.

The information specified in the example stated in your second question ("silver assay per 'dry tons ore treated.' ") is within the information which the state land commissioner is permitted to obtain from the lessee.

cc: Gerald A. Silva
Performance Audit Manager

APPENDIX IX

TABLE OF GRAZING FEES PER ANIMAL UNIT MONTH (AUM) AND AVERAGE CARRYING CAPACITY OF STATE LANDS FOR STATES WHICH OFFER GRAZING LEASES

TABLE OF GRAZING FEES PER ANIMAL UNIT MONTH (AUM) AND AVERAGE CARRYING CAPACITY OF STATE LANDS FOR ALL STATES WHICH OFFER GRAZING LEASES

States	Grazing Fee Per Annum	Average Per Acre Carrying Capacity
Alaska	2.00 (estimated)	24+
ARIZONA	.91	7
California	1.89	20-24
Colorado	3.00	15-19
Hawaii	3.33	Unknown
Idaho	3.50 (average)	5-9
Illinois	N/R	24+
Kentucky	2.50 (average bid)	Unknown
Minnesota	*	Unknown
Missouri	4.50 (average)	24+
Montana	3.64	10-14
Nebraska	12.00	1-4
New Hampshire	**	**
New Mexico	1.60	10-14
North Dakota	2.65	13-15
Oklahoma	7.41	Unknown
Oregon	2.50	24+
South Dakota	3.73	24+
Texas	4.50	20-24
Utah	1.89	10-14
Washington	3.25	10-14
Wyoming	1.45	10-14

* Grazing fee is 5% of appraised value of leased land.

** Amount of lease fee set by area; carrying capacity is set annually by county agricultural agent.

*** Lease amount set by sealed bid.

N/R No response.

APPENDIX X

GLOSSARY OF TERMS PERTINENT TO GRAZING

GLOSSARY OF TERMS PERTINENT TO GRAZING

Beef Price Index (BPI)
An index of the weighted average annual price for beef cattle, excluding calves, for eleven western states as compared with a specific base period equal to 100.

Environmental Assessment
Includes costs of preparing and reviewing an environmental assessment report, including technical review, regardless of expertise or skills input.

Fences
Includes cost of fences to control movement and/or distribution of animals, and to protect seedlings, plantations, study plots or similar sites.

Forage Value Index (FVI)
A derived index of the relative change in the previous year's average monthly rate per head for pasturing cattle on privately owned land in eleven western states, using the base period of 1964-68 equals 100 ($3.65 per AUM). As an example, for 1974, the 1973 average monthly rate per head for pasturing cattle on privately owned lands was $4.57 per AUM; therefore, $4.57 divided by $3.65 (base) produces a Forage Value Index of 125.

Grazing Management
Includes costs of discharging the BLM's responsibilities relating to livestock use and management under the Taylor Grazing Act of 1934 and the Federal Land Policy and Management Act of 1976.

Maintenance:

Fences
Includes costs and time spent on maintenance of fences, enclosures and exclosures.

Land and Vegetative Treatment
Includes costs and time spent on maintenance of vegetative manipulation and land treatments such as plant control projects, seedings or water tillage projects. Includes such items as brush/hardwood control and grass control.

Maintenance: (Cont'd)

Management Facilities
Includes costs and time spent on maintenance of management facilities, e.g., cattleguards, antelope passes, archeological sites, air and water monitoring stations.

Water Facilities
Includes costs and time spent on maintenance of water facilities such as wells, springs and water control structures.

Management Facilities
Includes such work as cattleguards, animal passes, cultural resource or ruin stabilization, stock trails, water monitoring stations, gabions, spawning gravel placement, fish barriers and water diversions. Use with appropriate subactivities lends specificity to job.

Prices Paid Index (PPI)
An index of prices paid by farmers for commodities and services, interest, taxes and farm wages as collected and published by the Statistical Reporting Service in Agricultural Prices, as compared to a specific base period equal to 100.

Project Survey and Design
Includes costs of work layout, final survey, design, drafting plans and profiles, acquisition of permits and design review of facilitating projects, e.g., fences, bridges and culverts, and of construction projects such as buildings and roads. Includes site-specific field surveys to acquire data necessary for final design; does not include general reconnaisance and preliminary route or site analysis which may or may not result in a specific project.

Studies and Research
Includes costs and time spent in planning, initiating, conducting, administering or reviewing topical or site-specific study and research efforts whether contracted or prepared inhouse. Includes work such as use studies (e.g., recreation or forage), feasibility studies for telecommunications as well as research work. Also includes cost of actions relating to environmental studies. Does not include studies to evaluate an activity or extensive inventories such as forest inventory.

Vegetation Manipulation
Includes costs of all revegetation projects regardless of technology applied, e.g., seeding, hand-planting, spraying prescribed fire, plowing and chaining, if objectives are to change composition or characteristic of vegetative stands. Also includes contract planning, preparation, and administration and time spent acquiring seed and seedlings. Does not include site treatment to protect seedlings or for other purposes if the treatment is done as a separate job. Does not include costs of controlling noxious weeds.

Water Facilities

Includes costs of installing facilities to develop a source of water, e.g., springs, wells and reservoirs or facilities for purposes of controlling flood and sediment damage, or improving, guiding, or controlling stream flow. Use with appropriate subactivities denotes purpose of facility.

Water Right Acquisition

Includes costs of acquiring water permits for use of water in Bureau programs, regardless of issuing authority, e.g., State government or Corps of Engineers.

APPENDIX XI

ARIZONA LEGISLATIVE COUNCIL MEMORANDUM
MAY 28, 1980

ARIZONA LEGISLATIVE COUNCIL

MEMO

May 28, 1980

TO: Douglas R. Norton
Auditor General

FROM: Arizona Legislative Council

RE: Request for Research and Statutory Interpretation (0-80-21)

This is in response to a request submitted on your behalf by Gerald A. Silva in a memo dated May 13, 1980. No input was received from the attorney general concerning this request.

FACT SITUATION:

Arizona Revised Statutes sections 37-501 and 37-502 define trespasses on state land and establish penalties for committing trespasses on state land.

The state land department has the authority to enforce the statutes relating to trespasses on state lands. However, the statutes do not appear to specifically require that the state land department investigate and resolve instances of trespass on state lands.

The state land department is presently investigating the removal of native plants from state lands. A.R.S. section 37-501 does not have any specific statement regarding removal of native plants from state lands.

QUESTIONS PRESENTED:

1. Is the state land department specifically required to investigate and resolve instances of trespasses on state lands?

2. Is the state land department required to investigate and resolve trespass cases in which native plants are removed from state lands?

ANSWERS:

1. No.

2. No, see discussion.

DISCUSSION:

1. A.R.S. section 37-102, subsection A provides that:

A. There shall be a state land department, which shall administer all laws relating to lands owned by, belonging to, and under the control of the state.

A.R.S. section 37-132, subsection A, paragraph 1 provides that:

A. The state land commissioner shall:

1. Exercise and perform all powers and duties vested in or imposed upon the state land department, and prescribe such rules and regulations as are necessary to discharge those duties.

There is no law which specifically imposes a duty upon the department to investigate and resolve cases of trespass upon state lands. However, A.R.S. section 37-211, subsection A, paragraph 4 does provide that:

A. The state land commissioner may conduct investigations and experiments on the lands of the state to:

* * *

4. Obtain other information and data which will aid in the leasing, sale and administration of lands belonging to the state. (Emphasis added.)

In addition, A.R.S. section 37-132, subsection B provides that:

B. The commissioner may take evidence relating to, and may require of the various county officers, information upon any matter which he has the power to investigate or determine. (Emphasis added.)

It may also be argued that A.R.S. section 37-211 does not provide for a general grant of authority to the state land department to conduct investigations, but is limited to the classification and appraisal of state lands. (See A.R.S. Title 37, chapter 2, article 2.)

You may wish to recommend that the statutes be amended to provide that the state land department and the state land commissioner are required to conduct investigations regarding state lands under certain circumstances, and are specifically required to conduct investigations and resolve cases of trespass upon state lands.

2. As was stated in point 1, there is no law which specifically imposes a duty upon the state land department to investigate and resolve cases of trespass upon state lands, including cases in which native plants are removed from state lands. In addition, A.R.S. section 37-501 and other provisions of A.R.S. Title 37 do not specifically refer to removals of native plants from state lands. Therefore, the question which appears to require an answer is whether the state land department is authorized or has the power to investigate cases which involve the removal of native plants from state lands. A resolution of this question requires a review of the statutes relating to the powers and duties of the state land department and the commission of agriculture and horticulture.

A.R.S. section 37-102 sets forth the overall responsibility of the state land department for administration of state lands and grants it the broad authority to administer all laws relating to state lands. In addition, the department may request the attorney general or a county attorney to initiate civil and criminal actions to protect the interest of the state in lands, or their proceeds, within the state. (See Arizona Legislative Council Memorandum (0-80-5).)

A.R.S. section 37-502, subsection D provides that:

D. The state land department may also, without legal process, seize and take any product or property unlawfully severed from the land whether

it has been removed from the land or not, and may dispose of the product or property so seized in the manner prescribed by law for disposing of products of state lands.

Therefore, the department may seize native plants unlawfully severed from state lands, whether they have been removed from the land or not, without legal process. In addition, A.R.S. section 37-211, subsection A, paragraph 4 apparently authorizes the state land commissioner to conduct investigations regarding cases in which native plants are unlawfully severed from state lands.

A.R.S. Title 3, chapter 6 specifically provides for the protection of native Arizona plants. No person may lawfully take, transport or possess a native plant without obtaining a permit and any required wood receipts or tags and seals from the commission of agriculture and horticulture. The commission of agriculture and horticulture is authorized to make necessary rules and regulations to enforce the provisions of chapter 6. (A.R.S. section 3-902, subsection E.)

An analagous situation regarding the state land department and the game and fish commission was examined by the department of law and discussed in 76 Op. Atty. Gen. 4 (1976). The question was, "/w/hich agency makes and enforces decisions on questions of access /by hunters and fishermen/ as they arise?" The attorney general stated that:

> Both the Land Department and Game and Fish Commission have full grants of rule-making power incident to their statutory authority. Each has sanctions for violations of its laws and regulations. Each agency could presumably go to court on its own initiative to enforce a validly made rule or regulation relating to access. However, any unilateral guidelines or attempts at enforcement would probably create confusion and tend to get the courts enmeshed in administrative decision making. Indeed, it may be that a court would ultimately find legislative intent to vest authority on questions of access exclusively in one of the two agencies. . . .
>
> In our view, however, the best approach to interagency control of hunter access is suggested by the provisions of the Wildlife Habitat Protection Act, A.R.S. section 17-451, enacted by the Legislature in 1972 to give the Game and Fish Commission authority to close public lands to vehicular access upon a finding of damage to wildlife or wildlife habitat. . . .
>
> The clear import of this statute is that the Game and Fish Commission is the lead agency charged with making the necessary factual determinations and initiating the closure order "with the concurrence of the land management agency involved . . . .". . .
>
> Concededly, the Wildlife Habitat Protection Act applies only to closures, and not to the general problem of hunter access. Nonetheless, in the absence of specific legislative direction, we believe that the interagency procedure set forth therein constitutes both the most practical approach to access control and the best approximation of what the Legislature might do if actually confronted with the problem.
>
> In conclusion, we believe that questions of hunter access should in the first instance be referred to the Game and Fish Commission which should initiate solutions, recognizing that the concurrence of the Land Department will be necessary to implement them. The adoption of joint regulations by

both agencies setting out general access standards and the procedural means of enforcement would, in our view, be the most effective method of achieving these results.

It is difficult to speculate how the attorney general or the courts would resolve potential jurisdictional conflicts between the state land department and the commission of agriculture and horticulture. You may wish to recommend that the statutes be amended to clarify the powers and duties of the department and the commission and intent of the legislature.

CONCLUSION:

1. There is no law which specifically imposes a duty upon the state land department to investigate and resolve cases of trespass upon state lands.

2. The state land department may, but is not required to, investigate and resolve cases of trespass in which native plants are removed from state lands. However, the exercise of its authority may result in a conflict with the enforcement of the law relating to native plants by the commission of agriculture and horticulture.

cc: Gerald A. Silva
Performance Audit Manager

APPENDIX XII

SUMMARY OF AUDITOR GENERAL SURVEY OF STATES WHICH HAVE ENACTED TRESPASS LAWS

SUMMARY OF AUDITOR GENERAL SURVEY OF STATES
WHICH HAVE ENACTED TRESPASS LAWS

State	Number of Employees Assigned to Trespass	Employees are Permitted to Issue Civil Citations	Penalties			Measures Taken to Discourage Trespassers
			Fine	Jail	Other	
Alabama	4	Yes	$1,000	1 yr.	Pays damage	Posting of signs; warnings issued to trespassers
ARIZONA	1/2	No			Triple damages	
California	30	No				
Colorado	5	No	$ 25 to $ 100			
Georgia	2	No	$1,000	1 yr.		Posting of signs; fences built
Hawaii	1	No				
Idaho	3	No	$ 500	6 mo.	Triple damages	Posting of signs; vigorous prosecution
Illinois	10	Yes	$ 350			
Michigan	7	Yes			Triple damages	
Nebraska	3	Yes	$1,000 and	6 mo.		
New Hampshire	4	Yes	$1,000 and/or	1 yr.	Triple damages	Vigorous prosecution of trespassers
New Jersey	1	Yes				
New Mexico	9	No	$ 500 and	6 mo.		
New York	12	Yes		1 yr.		Fences built; vigorous prosecution
Pennslyvania	1	Yes	$1,000 and/or	1 yr.		Special patrols in remote areas
Rhode Island	1	Yes		6 mo.		
Tennessee	2	Yes		1 yr.		
Texas	16	Yes		1 yr.		
Washington	4	Yes	$1,000			
Wisconsin	1	No				

APPENDIX XIII

ARIZONA LEGISLATIVE COUNCIL MEMORANDUM
FEBURARY 22, 1980

ARIZONA LEGISLATIVE COUNCIL

MEMO

February 22, 1980

TO: Douglas R. Norton, Auditor General

FROM: Arizona Legislative Council

RE: Request for Research and Statutory Interpretation (0-80-5)

This is in response to a request submitted on your behalf by Gerald A. Silva in a memo dated February 8, 1980. No input was received from the Attorney General concerning this request.

FACT SITUATION:

The state land department derives its enforcement powers for trespasses on state lands from Arizona Revised Statutes sections 37-501 and 37-502.

QUESTIONS PRESENTED:

1. What action can the land department take to enforce the trespass provisions of the statute?

2. What actions can or must the county officers take to enforce the trespass provisions of the statute?

3. What enforcement powers do other state regulatory agencies have available to force compliance with the state statutes?

4. What is the statute of limitations, if any, regarding recovery of damages for trespass on state lands?

DISCUSSION:

1. Arizona Revised Statutes section 37-102, subsections A and C provides that:

A. There shall be a state land department, which shall administer all laws relating to lands owned by, belonging to, and under the control of the state.

* * *

C. The department may, in the name of the state, commence, prosecute and defend all actions and proceedings to protect the interest of the state in lands within the state or the proceeds thereof. Actions shall be commenced and prosecuted at the request of the department by the attorney general, a county attorney, or a special counsel under the direction of the attorney general.

In addition, Arizona Revised Statutes section 37-502, subsections A and D provides that:

> A. Whoever commits any trespass upon state lands as defined by section 37-501 is also liable in a civil action brought in the name of the state in the county in which the trespass was committed, for three times the amount of the damage caused by the trespass, if the trespass was wilful, but for single damages only if casual or involuntary.
>
> * * *
>
> D. The state land department may also, without legal process, seize and take any product or property unlawfully severed from the land whether it has been removed from the land or not, and may dispose of the product or property so seized in the manner prescribed by law for disposing of products of state lands.

Therefore, the state land department may seize products or property unlawfully severed from state lands without legal process. In addition, it may request the attorney general or a county attorney to initiate civil and criminal actions to enforce the provisions of Arizona Revised Statutes sections 37-501, 37-502 and 13-1502 through 13-1504.

Arizona Revised Statutes section 37-501 provides that:

A person is guilty of a class 2 misdemeanor who:

> 1. Knowingly commits a trespass upon state lands, either by cutting down or destroying timber or wood standing or growing thereon, or by carrying away timber or wood therefrom, or by mowing, cutting, or removing hay or grass thereon or therefrom, or grazing livestock thereon, unless he has an application pending for leasing the lands or the lands are then leased to any other person.
>
> 2. Knowingly extracts or removes oil, gas, coal, mineral, earth, rock, fertilizer or fossils of any kind or description therefrom.
>
> 3. Knowingly without right injures or removes any building, fence or improvements on state lands, or unlawfully occupies, plows or cultivates any of the lands.
>
> 4. With criminal negligence exposes growing trees, shrubs or undergrowth standing on state lands to danger or destruction by fire.

The above statute penalizes criminal trespass upon state lands if it is joined with damage or removal of property, except that unlawfully occupying, plowing or cultivating state land is also a criminal trespass. Arizona Revised Statutes sections 13-1502 through 13-1504 prescribe the definitions and classifications of other criminal trespasses which may be the basis for the initiation of a criminal proceeding by the state land department if Arizona Revised Statutes section 37-501 does not suffice. (See Arizona Criminal Code

Commission, Arizona Revised Criminal Code xiv (1975) and R. Gerber & J. Foreman, Arizona's Criminal Law: The Critical Need For Comprehensive Revision, 18 Ariz. L. Rev. 90 (1976).)

Arizona Revised Statutes section 37-502, subsection E prescribes that:

> E. The county officers of the several counties shall report to the department any trespass upon state lands which comes to their knowledge.

In addition, as was stated in point 1, the state land department may request a county attorney to initiate civil and criminal actions to protect the interests of the state in its lands.

All peace officers, i.e., " . . . any person vested by law with a duty to maintain public order and make arrests . . . " (Arizona Revised Statutes section 13-105, paragraph 20), may, without a warrant, arrest a person:

> 2. When he has probable cause to believe a misdemeanor has been committed in his presence and probable cause to believe the person to be arrested has committed the offense.
>
> * * *
>
> 4. When he has probable cause to believe a misdemeanor has been committed and probable cause to believe the person to be arrested has committed the offense. The person so arrested shall be released in conformity with the provisions of section 13-3903.

(Arizona Revised Statutes section 13-3883.)

Arizona Revised Statutes section 11-441, subsection A, paragraphs 1 and 2, specifically prescribes that the county sheriff shall:

> 1. Preserve the peace.
>
> 2. Arrest and take before the nearest magistrate for examination all persons who attempt to commit or who have committed a public offense.

Therefore, the county sheriff is required to arrest a person who commits a criminal trespass upon state lands; county officers are required to report a trespass upon state lands to the state land department; and the county attorney may be requested by the state land department to initiate civil and criminal actions against a person who commits a criminal trespass upon state lands.

3. An examination of the enforcement powers and duties of several other state agencies disclosed that some have the power to issue citations to a person violating a

provision of the statutes which the agency has a duty to enforce, and some may exercise the powers of peace officers with the primary duty the enforcement of statutes which the agency has a duty to enforce.

For example, Arizona Revised Statutes section 23-415 provides that if the director of the industrial commission, division of occupational safety and health determines, following an inspection or investigation, that there is reasonable cause to believe that a violation of safety and health standards and regulations exists, he shall issue a citation to the employer.

Arizona Revised Statutes section 28-2307 provides that motor vehicle division investigators shall have " . . . the authority of peace officers throughout this state and the power to administer oaths, acknowledge signatures and serve any subpoena or other process." In addition, the authority to exercise the powers of peace officers is given to the game and fish department's game rangers and wildlife managers (Arizona Revised Statutes section 17-211), investigators employed by the attorney general or a county attorney (Arizona Revised Statutes section 41-192.03) and park ranger law enforcement officers employed by the state parks board (Arizona Revised Statutes section 41-511.09).

4. The offenses defined in Arizona Revised Statutes sections 37-501 and 13-1502 through 13-1503 are declared to be misdemeanors, classified respectively as a class 2 misdemeanor (see Arizona Revised Statutes section 13-602), a class 3 misdemeanor and a class 2 misdemeanor. An offense defined in Arizona Revised Statutes section 13-1504 is declared to be either a class 6 felony or a class 1 misdemeanor based upon how the person commits the criminal trespass. The statute of limitations for all misdemeanors is one year, and the statute of limitations for a class 6 felony is seven years (Arizona Revised Statutes section 13-107). The state is subject to the statute of limitations for a criminal proceeding against a person who commits a trespass.

The general statute of limitations for a civil action against a person who commits a trespass is two years (Arizona Revised Statutes section 12-542). However, the state is not barred from commencing a civil action against a person who commits a trespass upon state lands after two years after the cause of action accrues (Arizona Revised Statutes section 12-510).

CONCLUSIONS:

1. The state land department may initiate civil and criminal actions to protect the interests of the state. It may without legal process seize products or property unlawfully severed from state lands.

2. The county sheriff is required to arrest a person who commits a criminal trespass upon state lands. County officers are required to report a trespass upon state lands to the state land department. The county attorney may be requested to initiate civil and criminal actions against a person who commits a criminal trespass upon state lands.

3. Some state agencies are authorized to issue citations to a person violating a provision of the statutes which the agency has a duty to enforce, and some may exercise the powers of peace officers with the primary duty the enforcement of statutes which the agency has a duty to enforce.

4. The statute of limitations for initiating a criminal proceeding for most criminal trespasses is one year, and the state is subject to the statute of limitations. The state is not barred by the statute of limitations from commencing a civil action against a person who commits a trespass upon state lands.

cc: Gerald A. Silva
Performance Audit Manager