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July 23, 1995
VIA FAX 670/322-2267

Deanne Siemer, Esq.
General Counsel
Third Constitutional Convention
Commonwealth of the Northern Mariana Islands
Saipan, MP 96950

Re: Article XI; July 21, 1995 Draft

Dear Deanne:

We welcome the opportunity to comment on this draft of Article XI. As you know, I represent Jeanne Rayphand and Stanley Torres, the plaintiffs in the taxpayer's lawsuit *Torres and Rayphand v. Tenorio*, which challenges the Governor's lease of 38,000 square meters of public land to L & T Group of Companies as a breach of fiduciary duty.

Also, for a period of nearly ten years (1985-1994), we served as counsel to the Marianas Public Land Trust.

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The *Torres* case presents a number of issues for the first time, which bear on the precise nature of the fiduciary duty

of the public land administration and what constitutes a breach of trust. The draft does not seem to be aware of those decisions and issues.

The idea of putting the administration of public land back in the hands of an independent agency is good, I think. That should isolate it from politics, at least to some extent. But, its independence will not cure the past problems of (1) actual or potential corruption of Bureau officials, (2) sheer indifference to the public interest and (3) gross incompetence. Some effort should be made to solve those problems.

It is established by Commonwealth decisional law (see the cases cited in the *Torres* opposition) that the Marianas Public Land Corporation was a trustee of public lands, charged with fiduciary duties.

We read Executive Order 94-3 to have substituted the Governor for the MPLC as trustee, without altering the trust character of the administration of public lands.

We strongly recommend that both the text and the official explanation make it completely clear that the ownership and management of public lands is a trust function. Unless this is made clear, those who favor a looser standard will contend that the Bureau is nothing more than an *administrative agency* and its conduct is subject to judicial review under the Commonwealth Administrative Procedure Act (which is modelled on the federal APA). Under the APA standard, as you know, the court cannot set aside agency action unless it is contrary the constitution, a statute, arbitrary, capricious and unreasonable, etc. Any attempt to challenge the Bureau's actions would have to clear the deference to the agency's expertise hurdle, which is either high or low, depending on the personal predilections of the judge hearing the case.

And, if the legislature passes a law which purports to commit the matter of the administration of public lands to "agency discretion," then the Bureau would be insulated from accountability in the courts.

If trust principles govern (as the clause "shall be held to strict standards of fiduciary care" provides), then something should be said in the committee report about the kinds of things that are discussed in the cases which define the precise nature of the trustee's duties, in a land management context.

The school trust lands cases are a good example. The trustee holds the land in trust. The trustee has a duty to make the land productive, or otherwise use or dispose of it in a manner which is clearly (and strictly) beneficial to the trust. The land cannot be sold or leased except at the "best possible price." The trustee must obtain an appraisal of the property by a competent, independent real estate appraiser. The real estate appraiser must be selected by and beholden to the trustee and not to the prospective lessee or buyer. If the trustee decides to lease the property for commercial development, the trustee must "test the market" in an appropriate way, to attract the best possible developer, considering all relevant criteria, including price. The trustee must make a reasonable effort to determine the "highest and best use" of each parcel of property, taking into consideration the public interest, including the interest in generating revenue.

The trustee's administration of the trust should always be subject to judicial scrutiny, in accordance with trust principles. Here, that means, in addition to the decisions mentioned above, the Restatement of Trusts 2d, which, as you know, is incorporated as positive law of the Commonwealth in the absence of statutory or decisional law.

Section 4(a) is right to hold the "directors" to strict fiduciary standards. It would help to call them "trustees" to make sure they are constantly reminded of the nature of their duty. And since you have the same trust language ("shall be held to strict standards of fiduciary care") in both § 4(a) and § 8(a) (relating to the Marianas Public Land Trust), the all the terminology should be consistent with trust principles and vocabulary.

The word "trustees" should be substituted for the word "directors" in § 4(a) to make the terminology of the Article consistent with the terminology used in trust law.

The word "administer" should be substituted for "direct" in § 4(a) to make the terminology of the article consistent with the terminology used in trust law.

In § 4(a), the term "shall direct the affairs" should read "shall administer the public lands trust for the benefit of the people" etc.

In § 5(d), for example, the clause "The bureau shall administer the public lands in accordance" etc. should be substituted for the term "operate in accordance" etc. to be consistent with the terminology in use in the trust context.

When we had occasion to analyze the relationship between the two agencies, the land management agency (the Corporation) and the funds management agency (the Trust), we concluded that the the Corporation holds legal title to the public lands as a trustee for administration of the public lands, the Trust is the sole beneficiary of the Corporation, the terms of the trust require the Corporation to promptly pay the net distributable income of the Corporation to the Trust. The Trust holds the funds which it receives from the Corporation in trust, it must invest those funds with care, prudence, etc., and the Commonwealth is the sole beneficiary of the Trust, to receive the net distributable income of the Trust.

It should be made clear that a trustee who is guilty of a breach of trust is personally liable to make the trust whole.

If these concepts are used, then you will need to do something with the "reasonable notice, a solicitation for competing bids, and public hearing" language in § 5(a).

To include the legislature in the approval process causes disruption and confusion in the administration of the trust. It divides the fiduciary duty between the trustee, the Bureau, and the Legislature. And, the legislature is more subject to

political and other extraneous influences that the Bureau (or at least more so that the Bureau should be).

The administration of the public land trust should be governed by "strict fiduciary standards" as they are defined in the context of land management, undiluted by politics.

The MPLC was notoriously incompetent, inefficient, and worse.

How to ensure that the Bureau will do a *good* job and do the *right* job? Require direct democratic election of members elected by the people, like the board of education? Is the management of public land as important to the people as the management of the educational program?

A recall provision should be considered. A recall provision with very liberal terms (a petition of 10% of the number of electors voting in the last election) would be a constant reminder to the trustees of their fiduciary duty.

If you decide to do something like the foregoing, then you will need to make it clear that Article XI is self-executing, in its entirety, including the provisions governing the Marianas Public Land Trust.

You will also have to deal with the potential problem that the Legislature may set about to amend the substantive trust law in an effort to indirectly amend Article XI. That was the rationale of Public Law 8-32. See Letter of Rexford C. Kosack to Jose R. Lifoifoi, dated July 20, 1995.

The principle that the constitution is couched in the legal vocabulary as it existed at the time of its adoption will have to be made explicit, to preclude legislative amendment of Article XI. Or, you will have to define all the key terms in the text and make it clear that the legislature cannot re-define them.

The current legislature enacted a law which purported to authorize the Marianas Public Land Trust to deposit its funds in a local bank, without regard to whether its deposits are

insured by the Federal Deposit Insurance Corporation. The purpose of the legislation was to enable the Trust to deposit its funds in the Bank of Saipan. The Chairman of the Trust is general manager of the Bank of Saipan, who is also brother-in-law to the Governor.

There is a current dispute between the Governor and the Trust over the question whether the trustees can use trust assets to to finance local housing development, by making some kind of grant or loan to the Commonwealth Development Authority. The CDA has a substantial non-performing loan portfolio. I am told that its audited financial statements have not been released for the past two years or so, because the CDA cannot agree with audit exceptions insisted upon by the auditor.

There are some technical problems with Section 8, relating to the Marianas Public Land Trust.

The text of § 8(b) refers to "investments . . . in obligations purchased in the United States." The report says that this means "bonds purchased in the United States market." Does this mean bonds "issued by the United States" or in other words U.S. treasury bonds, or does it include corporate bonds, municipal bonds, and other kinds of bonds which may be purchased on the United States bond market?

The commentary says that "The trustees may not speculate in foreign markets." Well, they may not "speculate" anywhere, anytime if they are to be "reasonable, careful and prudent."

Some investment advisers, at some times, have recommended investment in the foreign, developing markets. Some investors have made a lot of money in the Hong Kong, Singapore, Tokyo and Manila markets. Some foreign securities (listed in U.S. dollar equivalents) can be purchased on the New York Stock Exchange.

The commentary on equity investments does not say anything about "foreign markets."

If the trustees will be invested with the authority,

responsibilty and the discretion to determine what are "reasonable, careful and prudent investments" then you should be very sure that this arbitrary allocation of 40% of the assets to fixed income securities will not tie the trustees hands unduly.

To limit the investments to one exchange (presumably the New York Stock Exchange) may not be wise; there are good investment available on the American Stock Exchange.

What the trustees should do, in general, is invest the assets of the trust in a balanced portfolio of cash equivalents, fixed income securities and equity investments. They may, in the exercise of reasonable care and prudence, need to vary the allocation of assets among those three categories from time to time, depending on market conditions.

The objectives of the trust are: (1) to protect the security of the assets; and (2) maintain a reasonable balance between production of current distributable income, on the one hand, and maintenance and growth in the value of the assets, on the other. Striking the balance between these competing objectives requires the exercise of prudent judgment, over time.

During the time that we were counsel to the Trust, the Trust had a financial adviser from Merrill Lynch who helped the trustees select and hire professional money managers in the United States to manage the Trust's investment portfolio in accordance with explicit guidelines developed and adopted by the trustees.

If the trustees failed to obtain such professional help and advice, they would surely be guilty of a breach of fiduciary duty.

Why is § 8(c) included, at all? Shouldn't the trustees be able to make the decision whether to invest in local mortgage backed loans in the exercise of their judgment? And, if the investment turns sour, then they are liable if it was unreasonable and imprudent to have made it.

By the way, I cannot find any "mortgages and loans" in § 6(a) of the July 21 draft. The clause "forty percent of interest earnings each year" should be changed to read "forty percent of trust assets." "Interest" is the name used to refer to the "income" received on the investments in fixed income securities. The 40% limitation only makes sense if it governs the amount of the assets which the trustees are allowed to allocate (and therefore put at risk) to that kind of investment.

But why limit them to 40%? If they are required, as reasonable, prudent, careful trustees, to maintain a balanced investment portfolio which gives due weight to each of the objective stated previously, then that takes care of it.

The "fund or guarantee the maintenance of the permanent preserves" language should be deleted. The cost of "maintenance of the permanent preserves" is an allowable administrative expense of the Bureau under § 5(e). That cost will be chargeable to the Bureau's revenues, before computation of the net income which is distributable to the Trust.

Regarding § 5(e), is there a good reason for allowing the Legislature and the Governor to have a veto power over the Bureau's budget? This, again, cuts against its independence and its trust responsibilities. How can you hold a trustee to "strict standards of fiduciary care" if you don't let the trustee manage the assets of the trust, including the costs of administration of the trust?

In this connection, it seems to me, the relationship with the legislature should be one-way. Let the Bureau get money from the Legislature to help develop the homesteads and the permanent preserves, but don't let the Legislature tell the Bureau what to do with its money, except for the money which the Legislature gives out of the general fund.

The § 5(e) language which reads "shall transfer these moneys promptly to the Marianas Public Land Trust . . . " should be modified to read: "shall transfer its annual net income to the

Marianas Public Land Trust promptly after the close of each fiscal year, except that . . . "

The reason for this is that after the initial transfer of the $26 million from the Corporation, which was forced by court order in the *Romisher v. Marianas Public Land Corporation* case, the Corporation refused to make annual distributions to the Trust of its net revenue. It always hokied up some "reservation" for future uses. It could, properly, reserve portions of net revenue to meet present obligations which required future payments. But it deliberated horded *all* of the net, until the Trust threatened to sue. Then it dribbled out $500,000 once and (if I recall) another $500,000 later, but in the meanwhile it withheld millions. And then, went broke!

Bruce MacMillan is the best informant on all of these details.

The amount of the distributions to the Trust, from the Bureau, will affect the investment options of the trustees. If no contributions, then the trust will have to shift its portfolio more in favor of growth than income.

I am not able to understand, off-hand, why the "exclusive control" language is included in § 8(b). Exclusive of what or whom?

It is imperative that the Trust's independence be assured. The self-executing nature of the section should be made explicit, so that the legislature cannot interfere.

I will dig out and send along two memoranda that we did for the Trust, when the Governor asked for a distribution to buy back the part of the Tinian military retention area that the military was willing to relinquish.

Section 6(d) of the current Article XI has been dropped. Ambassador Williams will go crazy when he sees that! Section 803(e) of the Covenant requires the Trust to maintain two separate funds, the general fund and the American Memorial Park Fund. The Park Fund started with $2 million in assets. Its net distributable income is restricted to use for the

development and maintenance of the Park. It cannot be given to the Commonwealth general fund.

You must put section 6(d) back in!

Forgive the rushed nature of this piece. I am banging it out at home on a Sunday evening, without my files or books at hand. I hope I have not overlooked something.

Sincerely,

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[CONVENT.107]

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