EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

1/20/89

MEMORANDUM FOR DAVID Q. BATES
CABINET SECRETARY

FROM: Robert E. Grady
Associate Director
for Natural Resources,
Energy and Science

SUBJECT: Cabinet Affairs Staffing Request regarding recommendations affecting the Northern Marianas

The incoming document from the President's Special Representative for the Consultations with the Northern Marianas contains recommendations on numerous issues regarding the Northern Marianas relationship with the U.S. Two of the issues are discussed in detail, while the remaining ones are mentioned briefly in title.

Recommendation:

OMB recommends that the document should not be cleared at this time. Agencies need at least two weeks to review the package, as the recommendations contained have significant policy and budget impacts. We understand that Treasury, in particular, will have strong objections to the recommendation that exempts from Federal income taxes, interest paid on bonds.

Attachment

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

Enclosed are two letters to you from the Special Representatives to the 902 Consultations which are joint recommendations for Executive Action.

I believe that both of these recommendations are sound, both from policy and legal standpoints. I, of course, urge you to have the other departments review and comment on them prior to your making a final decision.

There are other recommendations which need further deliberation both within the Federal Executive Branch and within the CNMI government, but I believe the progress demonstrated by the two enclosed is an excellent encouragement for betterment of our relations.

Again, thank you for your allowing me to serve in this important capacity.

Sincerely,

Becky Norton Dunlop
Assistant Secretary for
Fish and Wildlife and Parks

Enclosures

United States Department of the Interior

WASHINGTON, D.C. 20240

OFFICE OF THE
ASSISTANT SECRETARY

January 4, 1989

The President
The White House
Washington, D.C.

Dear Mr. President:

Serving as your personal representative to the 902 Consultations with the Governor's representatives of the Commonwealth of the Northern Marianas has been a challenging and rewarding opportunity for me.

The people of the CNMI have exhibited a deep and abiding commitment to the guarantees of freedom and stability which come from being a part of the United States family, an appreciation for the U.S. Citizenship which they were afforded by the mutual ratification of the Covenant and the experience of the benefits and frustrations of federal programs provided to them by virtue of their broad acceptance of U.S. sovereignty.

However, Mr. President, there also are concerns about the seeming lack of confidence we have shown in their ability to manage their internal affairs through their democratically elected officials, the lack of consideration of their needs and preferences in Congressional actions, and recalcitrance of many federal agencies and bureaus in acknowledging that the CNMI is not a state, is many miles from our shores, has a unique, special and different set of needs and is an important part of our national fabric.

We need to move toward correcting these problems, Mr. President, and to that end I have the following recommendations to make to you and the Vice-President:

MIHA Bonds: In reaching a settlement of the MIHA Bond dispute, I recommend receding to the CNMI position as it pertains to the applicability of the cover over provision of the Covenant. The documents dealing with this issue are attached and basically the solution which I recommend is a policy decision which can be implemented with legal authority and defended in the courts. One of the basic issues affecting this consideration is that the Covenant was unilaterally amended by the Tax Reform Act of 1986 without representation by the citizens of the CNMI. This is unfair and had this amendment not occurred, the provisions of the Covenant would have made the IRS claim on this issue moot.

Representation in Congress: The citizens of the CNMI have no representation in Congress and as U.S. citizens, affected by many actions taken by the Congress, I believe that they deserve representation. I strongly recommend that you support a non-voting representative for the CNMI such as those representing the Virgin Islands and Guam. It can be left to the Congress to determine questions of staffing and funding this position.

Executive Branch Representation: I strongly recommend that you establish a position with the clear and delineated responsibility to ensure that the just interests of the CNMI are fully considered in the development and administration of federal policy; and, that federal policy applicable to the CNMI is communicated to the government and news outlets in the CNMI and is made available to the citizens.

Congressional actions affecting CNMI: I strongly recommend that you urge the Congress to exercise special care and deliberation in enacting legislation which has the effect of unilaterally amending any provision of the Covenant.

Report of the Commission on Federal Laws: I recommend that you propose to the Congress and urge the enactment of legislation incorporating those recommendations of the Second Interim Report of the Northern Mariana Islands Commission on Federal Laws on which there is broad consensus.

Mr. President, I am making a final trip to the CNMI on January 10 as your designee and plan to urge Governor Tenorio's designees to join with me in making these joint recommendations of the 902 Representatives. It is my hope that this will be a successful trip in this endeavor.

In any event, I am, with this letter, offering my resignation as your 902 Representative to the Consultations with the Commonwealth of the Northern Marianas effective at the pleasure of the President.

Once again, I thank you for the priviledge of working with the people of the CNMI.

Sincerely,

Becky Norton Dunlop

Becky Norton Dunlop
Assistant Secretary for Fish
and Wildlife and Parks

Attachments

Internal Revenue Service

memorandum

DWhite CC:FI&P

date: December 23, 1988

to: James R. Streeter, Special Assistant to the Under Secretary, Department of Interior

from: Acting Chief Counsel

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subject: Mariana Islands Housing Authority Bonds

The Commonwealth of the Northern Mariana Islands ("CNMI") has raised certain questions regarding the impact of the Covenant to Establish a Commonwealth of Northern Mariana Islands (the "Covenant") on the taxability of certain bonds issued in 1984 by the Mariana Islands Housing Authority ("MIHA"). You have requested our opinion concerning these questions for purposes of the Section 902 Consultations.

The CNMI claims that the interest on the bonds is not subject to federal income tax because it views the Covenant, which provides in section 607 that bonds issued by the CNMI are exempt from taxation by the United States, as a treaty or treaty equivalent that supercedes any Code provisions which may provide otherwise. The CNMI also claims that if interest on the Bonds is determined to be taxable the net proceeds of all taxes collected must be covered over to the CNMI treasury.

Our position is that the bonds must meet the requirements of section 103 of the Internal Revenue Code in order to be tax-exempt. This position is based on section 103(m) of the 1954 Code which provides that the interest on bonds issued after December 31, 1983, is not tax-exempt unless the bonds meet the requirements of the Code. This provision of the Code changed prior law under which certain bonds, such as bonds issued by Puerto Rico, could be tax-exempt notwithstanding their failure to meet the requirements of the Code. Our examination of the MIHA bonds indicates that they are similar to those described in Rev. Rul. 85-182, 1985-2 C.B. 39 and are not tax-exempt qualified mortgage bonds described in section 103A(c) of the 1954 Code.

Our position concerning cover over is that only a portion of any taxes collected should be covered over to the Treasury of the CNMI.

Legal Effect of the Covenant

The Covenant, by definition, is not a treaty or treaty equivalent. A treaty, entered into by the President with concurrence of two-thirds of the Senate, is a compact between independent nations. The Covenant, however, is a political status agreement which defines the relationship between the United States and the CNMI, a possession of the United States.[1]

The Covenant is similar to agreements executed by the United States with its other territories and possessions. These agreements are legislative acts of Congress and as such, are federal statues, not treaties. Had the United States considered the Covenant to be a treaty, the treaty ratification procedures would have been followed rather than the procedures for legislative action.

Moreover, whether the Covenant can be considered a treaty or treaty equivalent is not determinative because the provisions of the agreement and the Code at issue do not conflict. Thus, the rules of statutory construction for resolving conflicts between treaties and acts of Congress do not apply to this case.[2]

Section 607 of the Covenant simply grants bonding authority to the CNMI, and sets forth the general rule that the interest on bonds issued by the CNMI is exempt from federal taxation. As such, section 607 is a corollary to the general rule of section 103(a) of the Code which exempts from income tax the interest on state, local and territorial or possession bonds. Section 103(m) of the 1954 Code provides for an exception to the general rule. Accordingly, section 103(m) implicitly amends section 607 of the Covenant as well as all similar provisions of non-Code federal law. Thus, section 607 of the Covenant should be deemed to provide that bonds issued after December 31, 1983, by the CNMI or its authority are exempt from taxation by the United States only

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[1] Although, the CNMI did not become a U.S. possession until November 3, 1986 (termination date of the trusteeship agreement), prior to such date it was treated as a U.S. possession in most instances because U.S. laws applicable to Guam, unless specified otherwise, became applicable to the CNMI.

[2] Even if there was a conflict, however, section 103(m) of the 1954 Code would override any conflicting provisions of the Covenant on the matter because it became effective later in time. Section 103(m) became effective no earlier than 1982, whereas section 607 of the Covenant became effective in 1978.

if the requirements of the Code are met. This construction of the two laws is proper, especially in view of the well-established principle that laws should be construed harmoniously where that can be reasonably done.

Cover over of Taxes by the United States

The CNMI maintains that if the interest on the Bonds is taxable, then Code and non-Code statutes require the United States to cover over (i.e., transfer) into the CNMI treasury any federal income taxes received or collected from the holders of the bonds. Our position is that the cover over amount is limited to certain high income individual bondholders.

Under both the Code[3] and the non-Code statutes[4] the United States is required to cover over federal income taxes collected on income sourced within the CNMI. The sourcing rule under section 861(a)(1) of the Code provides that interest from the United States or its agencies or instrumentalities (other than a possession of the United States or an agency or instrumentality of a possession), a state or its political subdivisions, or the District of Columbia is treated as income from sources within the United States. Because the tax law of the CNMI is the "mirror image" of the Code[5], section 861, as applied on a mirror basis,

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[3] Section 7654 of the Code. Note: Section 7654 as added by section 1276(a) of the Tax Reform Act of 1986 (the "1986 Act") is not presently applicable to the CNMI because the effective date for the changes to the Code section depends upon the execution of an implementing agreement between the United States and the CNMI. Section 1277 of the 1986 Act. At this time, no implementing agreement has been entered into between the United States and the CNMI. Therefore, section 7654 as it existed prior to the Act applies to this case.

[4] Section 703(b) of the Covenant provides that there will be paid into the CNMI Treasury to be expended to the benefit of the people thereof as the CNMI may by law prescribe, the proceeds of all customs, duties and federal income taxes derived from the CNMI.

[5] Section 601(a) of the Covenant provides that the CNMI would generally apply the Code as its territorial income tax law by substituting the "CNMI" for the "United States" where appropriate in order to give the law proper effect in the CNMI (i.e., the mirror code system).

provides that the interest income on bonds issued by the CNMI or its agencies or instrumentalities, is treated as income sourced within the CNMI. Thus, we agree that the interest income is sourced within the CNMI.

Section 7654 of the Code outlines specific rules for cover over by the United States to the CNMI. Although section 7654 expressly refers to Guam, section 601(c) of the Covenant provides that all references in the Code to Guam are deemed also to refer to the CNMI.

Section 7654 of the Code is only applicable to individuals to which section 935 applies.[6] Under section 935, certain individuals (i.e., citizens or residents of the CNMI and citizens or residents of the United States who derive income from the CNMI) are to file tax returns with the United States or the CNMI (but not both) based upon their residency at the end of the year and, in addition, are relieved of any tax liability to the jurisdiction in which they are not required to file a return.

Although Congress believed that the single filing/single liability rules of section 935 of the Code would result in an equitable division of revenue in the case of most individuals, Congress recognized that this system could result in a distortion of the allocation of revenue between the United States and the possessions if the income of the individuals involved is relatively large and the gross income from sources within the other jurisdiction is of significant size. As a result, section 7654 provides that if the individuals have adjusted gross income of $50,000 or more and have gross income of at least $5,000 from the jurisdiction other than that in which they reside, their taxes are to be allocated between the United States and the possessions generally in proportion to the source of their income and covered over accordingly.

The cover over rules of section 7654 of the Code allow the United States and the possessions to collect and pay to the other jurisdiction income taxes derived from sources in the other jurisdiction but which are not subject to the taxing and collecting authority of the other jurisdiction due to the single filing rule. As a result, sections 935 and 7654 apply to individual taxpayers rather than corporate taxpayers because there is no single filing requirement for corporate taxpayers.

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[6]Section 935 of the Code, as amended by the Act is inapplicable to the CNMI because it has not entered into an implementing agreement. Thus, like section 7654, section 935 as it existed prior to the 1986 Act applies to this case.

Generally, corporate taxpayers have to file two income tax returns and satisfy their tax liability with the possessions and the United States if they have income that is sourced within both jurisdictions during the taxable year. Thus, cover over between the taxing jurisdictions involving corporate taxpayers is generally unnecessary since each jurisdiction has the authority to tax and collect from corporate taxpayers.

In this case, section 935 of the Code would require the United States to cover an amount into the CNMI treasury; however, this amount would be limited to the net collections from individual bondholders who had adjusted gross income of $50,000 or more and gross income of $5,000 or more derived from sources within the CNMI.

The CNMI maintains that the cover over provision of the Covenant (which is not limited in application to the amount of net collection of taxes of individual taxpayers who meet the $50,000/$5,000 test) is inconsistent with and should take precedence over section 7654 of the Code. Our position is that sections 935 and 7654 of the Code and section 703(b) of the Covenant can be construed harmoniously. Section 703(b) of the Covenant was intended by Congress to grant the benefit of cover over by the United States to the CNMI as had been previously done for other possessions. The cover over of certain duties, fees, and taxes is one of several methods used by the United States to provide financial assistance to the possessions.

Section 7654 of the Code prescribes the means by which the United States is to provide the benefit of cover over of federal taxes to the CNMI as well as other possessions. As such, section 7654 is neither manifestly incompatible nor conflicting with section 703(b) of the Covenant. By including section 703(b) in the Covenant, Congress manifested a clear intention to make section 7654 applicable to the CNMI. Finally, both the IRS and the Department of Revenue and Taxation of the CNMI have consistently administered sections 935 and 7654 as being fully applicable to the CNMI.

PETER K. SCOTT

Position Paper

By

The Special Representatives of the Governor of the Commonwealth of the Northern Mariana Islands

For the Section 902 Consultations

on

FEDERAL TAXATION OF M.I.H.A. BONDS

UNDERWRITTEN BY MATTHEWS & WRIGHT, INC.

INTRODUCTION AND SUMMARY

At the Third Round of the Section 902 Consultations, the Special Representative of the President of the United States designated "the MIHA bond issue" as an issue to be discussed at

the Section 902 Consultations. In the lengthy interval between the Third and Fourth Rounds of these consultations, the MIHA bond issue has also become an issue that, from the point of view of the Northern Mariana Islands, affects the relationship between the Commonwealth of the Northern Mariana Islands and the United States. Even though the Procedures call for the Special Representative of the President, as the party originally designating the issue, to prepare the initial position paper on the issue, the urgent need for resolution of this issue causes the Special Representatives of the Governor of the Commonwealth of the Northern Mariana Islands to present this position paper on the issue.

In December 1984, the Mariana Islands Housing Authority (MIHA), an entity of the Commonwealth government, issued $80 million in bonds to support the construction of housing in the Northern Mariana Islands. These bonds were intended by MIHA to be tax-exempt. The underwriter for these bonds was the New York firm of Matthews & Wright, Inc., which in turn is owned by Matthews & Wright Group, Ltd. Matthews & Wright and its personnel have subsequently come under severe attack for their role in underwriting municipal bonds for many governmental entities across the United States and the Pacific.

The houses were never built by MIHA. The bond issue was "collapsed," that is, the money borrowed by selling the bonds was repaid to the bondholders. The federal Internal Revenue Service in August 1988 declared that the MIHA bonds were not tax-exempt. Under the bond documents, the failure of the bonds to qualify for tax exemption requires that the Commonwealth indemnify the bondholders for any federal taxes they are required to pay.

Section 607(a) of the Covenant provides that "[a]ll bonds or other obligations issued by the Government of the Northern Mariana Islands or by its authority will be exempt, as to principal and interest, from taxation by the United States . . . ." On its face, Section 607(a) bars the federal Internal Revenue Service from taxing the interest on MIHA bonds.

The Special Representatives of the Governor of the Commonwealth of the Northern Mariana Islands, at the Third Round of these Consultations, presented their position paper, "Conflict Between the Covenant and the Internal Revenue Code with respect to Tax-Exempt Bonds." That position paper, although prepared without specific reference to the MIHA bonds, explains why the interest on those bonds is not subject to federal income tax.

There is an additional reason why the Federal Government should not attempt to collect income tax on MIHA bond interest. Section 703(b) of the Covenant requires the Federal Government to turn over to the Commonwealth the proceeds of all federal income taxes derived from the Northern Mariana Islands. The interest income on the MIHA bonds is clearly derived from the Northern Mariana Islands, so that any taxes on that income collected by the Federal Government must be turned over to the Commonwealth. The Commonwealth in turn is obligated by the bond instruments to indemnify the bondholders if the bonds are subjected to federal income tax. The net result is that the Commonwealth, the Federal Government, and the bondholders all end up in exactly the same position as they would have been in had not income taxes been collected on the MIHA bond interest payments. The exception to this equivalency is that substantial collection and transaction costs would have been incurred by collecting the taxes, covering them over to the Commonwealth, and indemnifying the bondholders.

The Internal Revenue Service has an April 15, 1989, deadline imposed by the statute of limitations for filing collection actions on the earliest MIHA bond interest payments. For this reason, the Special Representatives of the Governor recommend that, pursuant to Section 5.8 of the Procedures for the Section

902 Consultations, an Interim Report on the MIHA bond issue be prepared and submitted by the Special Representatives of the Governor and the Special Representative of the President.

PROPOSED LANGUAGE FOR AN INTERIM REPORT
OF THE SPECIAL REPRESENTATIVES

The Special Representatives of the Governor of the Commonwealth of the Northern Mariana Islands propose that the following language be incorporated into an Interim Report of the Special Representatives:

The Special Representatives recommend that a conclusive agreement be entered into between the Commonwealth of the Northern Mariana Islands and the federal Internal Revenue Service with respect to the taxation of interest payments on the 1984 Home Revenue Bonds issued by the Mariana Islands Housing Authority. That agreement should include the following recitations:

WHEREAS, the Mariana Islands Housing Authority is an entity of the Government of the Commonwealth of the Northern Mariana Islands; and

WHEREAS, Section 607(a) of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (the Covenant) provides that "[a]ll bonds or other obligations issued by the Government of the Northern Mariana Islands or by its authority will be exempt, as to principal and interest, from taxation by the United States . . . ."; and

WHEREAS, Section 607(a) of the Covenant, at the very least, raises a substantial legal issue as to whether any interest payments on bonds made by the Mariana Islands Housing Authority can be subject to federal taxation; and

WHEREAS, Section 703(b) of the Covenant provides that "[t]here will be paid into the Treasury of the Government of the Northern Mariana Islands, to be expended to the benefit of the

people thereof as that Government may by law prescribe, the proceeds of all . . . federal income taxes derived from the Northern Mariana Islands . . . ."; and

WHEREAS, as a consequence of Section 703(b) of the Covenant, any federal income taxes collected by the Federal Government would be required to be paid into the Treasury of the Government of the Northern Mariana Islands; and

WHEREAS, there is no loss in revenue to the Federal Government if the Internal Revenue Service does not collect income taxes on the interest payments made on the 1984 Home Revenue Bonds issued by the Mariana Islands Housing Authority; and

WHEREAS, all 1984 Home Revenue Bonds issued by the Mariana Islands Housing Authority have been redeemed and there are no such bonds now outstanding; and

WHEREAS, the Federal Government has initiated criminal proceedings, in the case of United States v. Goldberg and Mann, Criminal Case No. CR 87-00056 in the United States District Court for the Territory of Guam, against two of the principal individuals involved in the issuance of the 1984 Home Revenue Bonds of the Mariana Islands Housing Authority, specifically citing their role in that issue; and

WHEREAS, the United States Attorney for Guam and the Northern Mariana Islands has described the activities of those individuals as a complex wire and mail fraud scheme involving a number of small, financially unsophisticated Pacific and stateside local jurisdictions; and

WHEREAS, the Federal Government and the Commonwealth of the Northern Mariana Islands are desirous of reaching a speedy and equitable resolution of the respective rights, duties and obligations of the Federal Government, the

Commonwealth, and the individuals who purchased 1984 Home Revenue Bonds of the Mariana Islands Housing Authority; now therefore

THE UNITED STATES OF AMERICA AND THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS AGREE THAT:

The United States will not tax interest paid to holders of 1984 Home Revenue Bonds of the Mariana Islands Housing Authority.

WHY THE PROPOSED INTERIM REPORT SHOULD BE ADOPTED

The factual background

The Mariana Islands Housing Authority (MIHA) is an entity of the Government of the Commonwealth of the Northern Mariana Islands. 2 N. Mar. Is. Code sec. 4411(a).

In December 1984, MIHA issued $80 million in bonds to support the construction of housing in the Northern Mariana Islands. These bonds were intended by MIHA to be tax-exempt. The underwriter for these bonds was the New York firm of Matthews

& Wright, Inc., which in turn is owned by Matthews & Wright Group, Ltd. Matthews & Wright has subsequently come under severe attack for its role in underwriting the MIHA bonds as well as bonds for many other governmental entities across the United States and the Pacific.

The houses were never built by MIHA. The bond issue was "collapsed," that is, the money borrowed by selling the bonds was repaid to the bondholders. The federal Internal Revenue Service in August 1988 declared that the MIHA bonds were not tax-exempt. Under the bond documents, the failure of the bonds to qualify for tax exemption requires that the Commonwealth indemnify the bondholders for any federal taxes they are required to pay. Although such taxes could only be collected by the Internal Revenue Service from the bondholders on interest income for the three years the bonds were outstanding, that is, before they were collapsed, the Commonwealth has estimated that its total liability due to the declaration that the bonds are not tax exempt may be as high as $20 million.

This MIHA bond issue was the Commonwealth's first venture ever into debt financing of governmental functions. Nothing in the thirty-plus prior years of United States administration of the Northern Marianas had prepared the Northern Mariana Islands

for an undertaking of this nature. Indeed, the Commonwealth government had only been in existence for seven years when these bonds were issued.

At the time the MIHA bonds were issued, in December 1984, the Northern Mariana Islands were part of the Trust Territory of the Pacific Islands. Under the Trusteeship Agreement between the United States and the United Nations, the United States was legally obligated to protect the inhabitants of the Northern Marianas "against social abuses." Trusteeship Agreement for the Former Japanese Mandated Islands, Art. 6(3), 61 Stat. 3301, T.I.A.S. No. 1665, 8 U.N.T.S. 189 (1947);

The evolution of the MIHA bond issue, from conception to issue, is best told in the words of the United States Attorney for the Districts of Guam and the Northern Mariana Islands:

> 1. At all times herein relevant:
>
> (a) Arthur Abba Goldberg, hereinafter GOLDBERG, a defendant herein, was an Executive Vice President and major stockholder of Matthews & Wright, Inc., a New York underwriter, hereinafter M&W.

(b) Frederick L. Mann, aka Manfred Lothar Mann, aka "Dr." Mann, hereinafter MANN, was a "Municipal Finance Consultant" associated with M&W and operating in concert with M&W and GOLDBERG. MANN sometimes operated under the names "J.D. Moore & Co." and Mill Rate, Ltd.," for purposes of receiving payments. He also represented himself to be Director and Chairman of the Commercial Bank of the Americas, hereinafter CBA.

. . .

(i) John C. Zaccaro, Jr., hereinafter Zaccaro, was an employee of M&W;

(j) Phillip J. Kiefer, hereinafter Kieffer, was a consultant who conducted business under the name Municipal Resources: Management + Development, hereinafter MR:M+D.

. . .

2. From on or about January 1984 to the date of this Indictment [December 10, 1987], in the District of Guam and elsewhere, GOLDBERG and MANN, defendants herein, acting together and aiding and abetting each other, and in concert with others not charged herein, did devise a scheme or artifice to defraud the people and the local governments of various places within and without the United States, including the Territory of Guam, hereinafter Guam, the Commonwealth of the Northern Mariana Islands, hereinafter CNMI, the Republic of Palau, hereinafter Palau, at the time part of the Trust Territory of the Pacific Islands , and various other local jurisdictions of the United States of money and property including:

- The credit of the respective local governments, a valuable property right;

- The right to issue tax-exempt municipal bonds, a valuable property right of the respective governments;

. . .

- The monetary benefit of certain tax exemptions to potential bondholders of municipal or local government bonds issues;

. . .

and to take and obtain and apply for their own purposes, funds generated by the sale of municipal bonds to be issued by the local governments, all by means of false and fraudulent pretenses, representations and promises inducing, recommending and fostering the underwriting and issuance of municipal bonds in such a way as to impair the apparent tax-exempt status of such bonds, when the defendants well knew at the time that the pretenses, representations and promises would be and were false when made, and which scheme to defraud and to obtain money and property is set forth more fully below.

3. It was a part of the scheme that the defendants GOLDBERG and MANN, acting in concert with others, known and unknown, not charged herein, would promote, recommend and foster the issuance of inflated

amounts of municipal bonds by small, tax-exempt local issuers, such as Mariana Islands Housing Authority, hereinafter MIHA . . . , by various means, including the procurement and issuance of bogus opinions as to the tax-exempt character of the bonds, knowing full well that there was no reasonable expectation of the accomplishment of the projects upon which the bonds were asserted to be based, such inflated amounts being issued for the purpose of obtaining fees and payments for GOLDBERG's company, M&W, and for MANN and others, all to be obtained from the moneys to be generated by the sale of the inflated amounts of municipal bonds.

. . .

6. It was part of the scheme to defraud and to obtain money and property that sometime after December 1984, when an $80 million CNMI single family housing municipal bond was issued by Mariana Islands Housing Authority, hereinafter MIHA, GOLDBERG and MANN would cause Kieffer to sign a feasibility study purporting to support the $80 million dollar [sic] CNMI single family housing municipal bond. MANN and GOLDBERG knew full well that the feasibility study contained numerous

false and misleading estimates and figures which were intended to mislead the Treasury Department, and potential buyers of the proposed $80 million dollar CNMI bond issue into believing that the Commonwealth of the Northern Mariana Islands had a need for such a large housing bond. The bond had been issued without a feasibility study, in December 1984. This bogus feasibility study was ordered by GOLDBERG in 1985. As originally drafted by Aaron Barman, an employee of M&W, the study supported only a $35 million bond issue. The study was then inflated by Zaccaro upon GOLDBERG's direction, and signed by Kieffer, in order to deceive those who read it. MANN and GOLDBERG had intended to obtain the issuance by MIHA of a $200 million single family housing bond, but this was revised to $80 million between December 17, 1984, and the date of issuance. No program evaluation or study supported the $200 million or the $80 million. GOLDBERG and MANN sought to take advantage of the MIHA issuing authority to generate funds for themselves. The bogus feasibility study was accompanied by a cover letter signed by Kieffer which contained false representations and was backdated to March 1985, although the letter was not actually written until some months later. The

text of the bogus study was still being revised by GOLDBERG on M&W word processing equipment as late as February 1986.

7. It was part of the scheme to defraud and to obtain money and property that, upon issuance and sale of the $80 million dollar CNMI single family housing municipal bond issue, that both GOLDBERG and MANN would receive proceeds and cash generated by the sale of the bond issue including approximately $3,900,000 for M&W and approximately $370,000 for MANN.

United States v. Goldberg and Mann, Criminal Case No. 87-00056, Indictment, December 10, 1987, at 36-37, 38, 40-41.

The United States Attorney described the scheme more succinctly in his press release issued the same day the indictment was filed:

> [A]ccording to the indictment Goldberg and Mann were jointly charged with obtaining more than $11 million dollars by a complex wire and mail fraud scheme involving a number of small, financially unsophisticated Pacific and stateside local

> jurisdictions. The indictment charges that the defendants contrived a scheme to float inflated municipal bond issues in 1984, 1985 and 1986. According to the charges, the defendants used bogus feasibility studies, a shell offshore bank which had lost its license, bogus checks and bank accounts and worldwide wire transactions to promote a nationwide fraud involving over $2 billion in municipal bonds.

U.S. Department of Justice, Press Release (December 10, 1987), at 3. The United States Attorney commented that:

> This case, based on evidence developed by the FBI, the [Department of Interior's Inspector General], and before the Grand Jury, reflects . . . a national [Department of Justice] commitment to stop those who would try to "hustle" and defraud the people of small jurisdictions like Guam.

Id. at 4.

Matthews & Wright has not only run afoul of federal authorities in Guam. Federal grand juries in the Southern District of New York and the Eastern District of Pennsylvania are

investigating whether civil and criminal charges should be filed against the firm in connection with various municipal bond issues. The firm has been sued by some municipal bond issuers, by persons who bought municipal bonds underwritten by the firm, and by a developer under contract to build facilities financed by municipal bonds underwritten by the firm. The federal Securities and Exchange Commission is conducting an investigation of various municipal bond offerings, a significant number of which were underwritten by Matthews & Wright. In July 1987, the Commission issued a subpoena seeking information on 74 separate municipal bond issues; Matthews & Wright was the underwriter for 44 of those issues. See generally Matthews & Wright Group, Inc., 1987 Annual Report (Form 10-K), at pages 14-21 (filed with the Securities and Exchange Commission, July 11, 1988). The Commission has invited Matthews & Wright and three of its officers "to explain why the firm should not be charged with fraud and other securities-laws violations." "SEC Asks Matthews & Wright to Reply to Inquiry Against Firm in Fraud Case," Wall Street Journal, June 13, 1988, at page 5D.

One of the lawsuits against Matthews & Wright was filed by the Commonwealth of the Northern Mariana Islands. Commonwealth of the Northern Mariana Islands v. Matthews & Wright Group, Ltd., District Court for the Northern Mariana Islands, filed August 7,

1987. The complaint in that action alleges ten separate claims against Matthews & Wright and seeks an accounting of all monies received or expended in connection with the 1984 MIHA bond issue, compensatory and punitive damages, and injunctive relief.

There may well have been bad faith connected with the issuance of the MIHA housing bonds. If there was bad faith, however, it was not on the part of the issuer, the Mariana Islands Housing Authority, but on the part of the underwriter, Matthews & Wright. The United States Department of the Treasury should not argue that the Commonwealth of the Northern Mariana Islands is guilty of bad faith in the issuance of the MIHA bonds and, consequently, that income from the bonds should be subject to federal income tax at the same time the United States Department of Justice is asserting that the Commonwealth was "hustled," a financially unsophisticated victim of a complex wire and mail fraud scheme.

It has been reported that the Internal Revenue Service has never previously declared any municipal bond issue taxable. "IRS Said Near Action on Bonds," Philadelphia Inquirer, February 27, 1988, at page 9-C. If this is true, it is particularly

inappropriate, given the circumstances outlined above, that one of the first issues targetted for a declaration of taxability should be the MIHA issue.

All money received from the sale of the MIHA bonds to bondholders was repaid to the bondholders on or before December 1, 1987. The bond issue thus was outstanding from December 1984 to December 1, 1987; it is only whether interest paid to bondholders by MIHA during this three-year period is subject to federal tax that is at issue.

Section 607(a) of the Covenant bars federal taxation of interest on the MIHA bonds.

Section 607(a) of the Covenant provides, in pertinent part, that "[a]ll bonds or other obligations issued by the Government of the Northern Mariana Islands or by its authority will be exempt, as to principal and interest, from taxation by the United States . . . ." If the Federal Government declares interest on the MIHA bonds to be subject to federal income tax, the Northern Mariana Islands must contest that declaration in order to defend its rights under the Covenant, the basic document establishing the relationship between the United States and the Northern Mariana Islands.

The Special Representatives of the Governor of the Commonwealth of the Northern Mariana Islands presented to the Special Representative of the President a position paper, "Conflict between the Covenant and the Internal Revenue Code with respect to Tax-Exempt Bonds," at the Third Round of the Section 902 Consultations. See the Compilation of Documents for the Third Round, at page 315. That position paper presents in detail why Commonwealth bonds are not subject to federal income tax.

Any income tax collected by the Federal Government on interest income from the MIHA bonds must, pursuant to Section 703(b) of the Covenant, be paid to the Government of the Northern Mariana Islands.

If, despite the unqualified provisions of Section 607(a), interest on bonds issued under the authority of the Government of the Northern Mariana Islands were subjected to the federal income tax, the Federal Government would be obligated by Section 703(b) of the Covenant to pay any such tax collected to the Government of the Northern Mariana Islands.

Sections 1 and 11 of the Internal Revenue Code impose the federal income tax on individuals and corporations. 26 U.S.C. sec. 1, 11 (1986). Gross income is defined to include interest. id. sec. 61. Interest income is generally subject to federal income tax, although, as with other types of income, various adjustments and deductions are allowed in determining how much of the income of an individual or corporation is taxable. See id. secs. 62, 63.

Federal income taxes derived from the Northern Mariana Islands must be paid by the Federal Government to the Government of the Northern Mariana Islands. Section 703(b) of the Covenant provides:

> There will be paid into the Treasury of the Government of the Northern Mariana Islands, to be expended to the benefit of the people thereof as that Government may by law prescribe, the proceeds of all customs duties and federal income taxes derived from the Northern Mariana Islands, the proceeds of all taxes collected under the internal revenue laws of the United States on articles produced in the Northern Mariana Islands and transported to the United States, its

> territories or possessions, or consumed in the Northern Mariana Islands, the proceeds of any other taxes which may be levied by the Congress on the inhabitants of the Northern Mariana Islands, and all quarantine, passport, immigration and naturalization fees collected in the Northern Mariana Islands, except that nothing in this section shall be construed to apply to any tax imposed by Chapters 2 or 21 of Title 26, United States Code.

For current purposes, the pertinent portion of Section 703(b) is as follows:

> There will be paid into the Treasury of the Government of the Northern Mariana Islands, to be expended to the benefit of the people thereof as that Government may by law prescribe, the proceeds of all . . . federal income taxes derived from the Northern Mariana Islands . . . .

The negotiating history of the Covenant states that Section 703(b) provides for the payment to the Government of the Northern Mariana Islands "the proceeds of essentially all taxes and duties and fees collected with respect to the Northern Mariana Islands." The Covenant to Establish a Commonwealth of the

Northern Mariana Islands, Senate Report 94-433, at 65, 85 (Committee on Interior & Insular Affairs 1975); Approving the "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America," House Report 94-364, at 5 (Committee on Interior & Insular Affairs 1975); Marianas Political Status Commission, Section-by-Section Analysis of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, reprinted in The Covenant to Establish a Commonwealth of the Northern Mariana Islands: Hearings before the Subcommittee on Territorial & Insular Affairs of the House Committee on Interior & Insular Affairs, 94th Cong., 1st Sess. 626, 653 (1975) and in The Northern Mariana Islands: Hearings before the Senate Committee on Interior & Insular Affairs, 94th Cong., 1st Sess. 356 (1975); U.S. Dep't of Justice, Explanation of the Covenant (n.d. 1975?), reprinted in H.J. Res. 549 et al. to approve "The Covenant to Establish a Commonwealth of the Northern Mariana Islands: Hearing before the Subcommittee on Territorial & Insular Affairs of the House Committee on Interior & Insular Affairs, 94th Cong., 1st Sess. 384, 393 (1975).

Federal income taxes levied on interest paid on bonds issued under the authority of the Government of the Northern Mariana Islands are "federal income taxes derived from the Northern Mariana Islands."

Interest income from the MIHA bonds is derived from the Northern Mariana Islands. Section 861 of the Internal Revenue Code provides that:

> The following items of gross income shall be treated as income from sources within the United States:
>
> (1)INTEREST.--Interest from the United States or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of noncorporate residents or domestic corporations [with exceptions not here relevant] . . . .

Thus, interest on a bond issued by a governmental entity within the United States is income from a source within the United States. See Helvering v. Stockholms Enskilda Bank, 293 U.S. 84, 91-93 (1934); Helvering v. British-American Tobacco Co., 69 F.2d

528, 531 (2d Cir. 1934), affirmed, 293 U.S. 95 (1934). Regulations implementing section 861 make clear that "[t]he method by which, or the place where, payment of the interest is made is immaterial in determining whether interest is derived from sources within the United States." 26 C.F.R. sec. 1.861-2(a)(3).

Section 862 of the Internal Revenue Code provides that interest income not derived from sources within the United States shall be treated as income from sources without the United States.

The general principle established by sections 861 and 862 of the Internal Revenue Code is that interest income is derived from the jurisdiction in which the payor of the interest is located. "This obligation [to pay interest] has its source in the obligor, and thus the source of the payment of the obligation is the residence of the obligor. There the right to payment arises and there the right may be enforced. The only qualification is that the payment be actually made by the resident obligor or on its behalf and pursuant to its obligation." A.C. Monk & Co., Inc., 10 T.C. 77 (1948). Accord, Sumitomo Bank, Ltd., 19 B.T.A. 480, 483-84 (1930); Estate of McKinnon, 6 B.T.A. 412 (1927); Standard Marine Insurance Co., 4 B.T.A. 853, 861-62 (1926); Mertens, Law

of Federal Income Taxation, sec. 45-3.05 (looseleaf 1987). See also U.S. Draft Model Income Tax Treaty of June 16, 1981, art. 11(4), reprinted in [1 Tax Treaties] Fed. Taxes (P-H), para. 1022 (looseleaf 1981).

Accordingly, if any federal income taxes are levied on interest paid on bonds issued under the authority of the Government of the Northern Mariana Islands, Section 703(b) of the Covenant mandates that those taxes be covered over by the Federal Government into the Treasury of the Northern Mariana Islands.

There is, consequently, no loss of revenue to the Federal Government if it does not declare interest income from these bonds to be taxable.

CONCLUSION

The agreement proposed by the Special Representatives of the Governor offers an avenue for speedy resolution of whether taxes should be assessed on interest payments on the MIHA bonds. The thorny legal issues involved in any other resolution of the issue need not be argued now if the issue is compromised in this fashion. Lengthy and expensive litigation can be avoided.

Because of Section 703(b) of the Covenant, the Federal Government suffers no loss of revenue by entering into an agreement such as that we propose.

* * *

MEMORANDUM

SUBJECT: Nature of United States Obligations of Financial Assistance to the Commonwealth of the Northern Mariana Islands

INTRODUCTION

The Commonwealth of the Northern Mariana Islands, hereinafter CNMI, is comprised of 21 small islands, measuring approximately 184 square miles that is part of one of the three archipelagoes that make up the Trust Territory of the Pacific Islands, a United Nations trusteeship under the administration of the United States. 1/ The trust is termed a "strategic trusteeship" under the functional control of the United Nations Security Council, 2/ and the responsibilities of the United States are now administered by the Department of the Interior. 3/ On February 15, 1975, a Covenant to Establish Northern Mariana Islands was signed, and "submitted to the people of the Marianas in a plebiscite on February 20, 1975," 4/ which resulted in the approval of the Covenant by a vote of 78.8 percent. 5/

The Covenant, as well as legislation and executive agreements relating to the relationship between the CNMI and the United States contains provisions pledging the "full faith and credit of the United States" to make payments to the CNMI over a period of years. The enforceability of this pledge is the subject of this memorandum.

I. UNDERLYING AUTHORITY OF THE EXECUTIVE

The Covenant is a type of executive agreement. The President on numerous occasions has assumed international obligations on behalf of the United States. 6/ Up until the time

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1/ See S. REP NO. 94-596, on P.L. No. 94-241, reprinted in 1976 U.S.CODE CONG. & ADMIN. NEWS 448, 449.

2/ Id. at 450.

3/ Id. at 451.

4/ Id. at 452.

5/ Id.

6/ See L. HENKIN, FOREIGN AFFAIRS AND THE CONSTITUTION 173 at n. 1.

of the signing and ratification of the Covenant, the CNMI was a part of an United Nations trusteeship under the administration of the United States. 7/ The trusteeship is no longer in effect as far as the CNMI is concerned. That is, the trusteeship has not ended over Micronesia as a whole, but it is not applicable to the CNMI due to the assumption of their commonwealth status. 8/

7/ 61 Stat. 3301. For a brief history of the CNMI, see P.L. 94-241, S. REP NO. 94-596 reprinted in 197_ U.S.CODE CONG. & ADMIN. NEWS at 449-450.

8/

> On May 28, 1986, the Trusteeship Council of the United Nations concluded that the Government of the United States had satisfactorily discharged its obligations as the Administering Authority under the terms of the Trusteeship Agreeement and that the people of the Northern Mariana Islands . . . had freely exercised thier right to self-determination, and considered that it was appropriate for that Agreement to be terminated.
>
> * * *
>
> I [Ronald Reagan] determine that the Trusteeship Agreement for the Pacific Islands is no longer in effect . . . as of November 3, 1986, with respect to the Northern Mariana Islands.
>
> * * *
>
> The Commonwealth of the Northern Mariana Islands in political union with and under the sovereignty of the United States of America is fully established [as of 12:01 a.m., November 4, 1986].

Proclamation No. 5564, Nov. 3, 1986, 51 F.R. 40399 reprinted in 48 U.S.C.A. § 1681 at 571-72 (1987).

There is a separate and distinct question as to the exact time when material breach of the Covenant no longer constitutes adequate grounds for renunciation of the Covenant by the non-breaching party. That is, whether material breach by the United States of its obligations under the Covenant -- in exchange for which the CNMI relinquished claims to sovereignty in favor of political union with the United States -- constitutes adequate grounds for renunciation of the Covenant and political union on the part of the CNMI. The Covenant obligated United States financial asistance for $ 14 million for a period of seven years commencing in 1976

(continued...)

Prior to their becoming a commonwealth, although CNMI was subject to the trusteeship of the United States, and therefore they were not a territory or dependent possession of the United States, any agreements reached between CNMI and the United States must be considered to be between sovereigns. Thus, the closest analogy that appropriately describes the legal effect of the Covenant is an executive agreement, an agreement between the President and a foreign sovereign. The Supreme Court has held that executive agreements are a constitutionally permissible exercise of executive authority. [9/] The Court has also stated that

> A treaty is a "law of the Land" under the supremacy clause . . . of the Constitution. Such international compacts and agreements as the Litvinov Assignment have a similar dignity. [10/]

Both the Pink case, and Dames & Moore v. Regan, [11/] upheld the power of the executive to enter executive agreements which will have the same binding effect upon the nation that a treaty will have. Although not necessary in some cases where the President is relying upon his sole and inherent powers over foreign affairs, Congress can approve of executive agreements by "legislation or appropriation of funds to carry out their obligations." [12/] This converts an executive agreement into what is termed a congressional-executive agreement. In fact, "it is now widely accepted that the Congressional-Executive agreement is

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[8/] (...continued)
to continue "until Congress appropriates a different amount or otherwise provides by law." Covenant at Section 704 (d) (emphasis added). Thus, because both parties to the Covenant complied with their material obligations for the initial seven year period covered by the Covenant, and Congress has subsequently provided otherwise by law through approval of the Financial Agreement, the United States has fulfilled its obligations under the Covenant. The extent to which the United States is allegedly in breach of the later Financial Agreement consequently is solely a question of domestic law.

[9/] United States v. Pink, 315 U.S. 203 (1942).

[10/] 315 U.S. at 230.

[11/] 453 U.S. 654 (1981).

[12/] HENKIN, infra n. __ at 174 (citation omitted).

a complete alternative to a treaty. . . ." [13] Thus, the Covenant is a type of congressional-executive agreement. In contrast, the Agreement was entered into after the CNMI ceased to be sovereign and thus is a domestic law agreement similar in nature to that between a State and the Executive.

Both the Covenant and the Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands, hereinafter Agreement, were not self-executing. That is, both these agreements required implementation either by domestic legislation or an appropriation of funds. Such agreements and treaties do not arise to the level of a law of the land until they are executed by the subsequent act of Congress. [14] The Agreement calls for approval by both Congress and the President, and for payments by the United States and thus cannot become binding without implementing legislation. [15] But, once approved, they arise to the level of a congressional-executive agreement. Consequently, because the President had the authority to enter the Agreement and the Covenant, which were subsequently approved by Acts of Congress, they are fully binding on the United States.

II. CONTROLLING PROVISIONS FOR DOMESTIC LAW PURPOSES

As a matter of constitutional law, the Supreme Court has held that whenever a treaty and a statute:

> relate to the same subject, the courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either; but if the two are inconsistent, the one last in date will control the other . . . . [16]

Similarly, "[l]ike a treaty, [a congressional-executive] agreement is the law of the land, superseding . . . inconsistent provisions . . . in other international agreements or acts of Congress." [17] Nevertheless, for domestic law purposes, because these particular agreements were subsequently implemented by Acts

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13/ Id. at 174. See also 40 OP. ATT'Y GEN. 469 (1946) (Congressional-Executive agreement is the complete equivalent of a treaty and the supreme law of the land).

14/ Foster v. Neilson, 27 U.S. (2 Pet.) 253 (1829).

15/ See e.g., Agreement Part II, ¶ 1.

16/ Whitney v. Robertson, 124 U.S. 190 (1888).

17/ See supra note 11.

of Congress, the terms of the implementation control. As stated succinctly by Louis Henkin:

> International law is law for the United States and, we shall see, it is also law of the United States to be applied by the courts. But the Constitution does not forbid Congress or the President to exercise their powers in disregard of customary international law as it does not invalidate their violations of treaties and international agreements. 18/

This view was recently reaffirmed in Committee of United States Citizens Living in Nicaragua v. Reagan. 19/ Thus, because "congressional enactments cannot violate but can only supersede prior inconsistent treaties or customary norms of international law," 20/ any inconsistent provisions contained in the implementing Acts of Congress are controlling for domestic law purposes. Thus, although the Agreement permits the "Secretary of the Interior [to] propose deferral of Government of the Northern Mariana Islands operations funds pursuant to the Congressional Budget and Impoundment Control Act of 1974," 21/ this provision is superseded by the inconsistent provision in the implementing appropriations legislation which states that "the Secretary of the Interior may request authority from Congress to withhold payment of an appropriate amount of the operations funds . . . for a period of less than one year but no funds shall be withheld except by Act of Congress." 22/ Thus, for domestic law purposes, despite compliance with the dispute resolution methodology set out in the Agreement, the Secretary may not unilaterally withhold funds pursuant to the Agreement, rather he may only request that Congress pass legislation to withhold funds.

Similarly, if the United States reneges on its promise to pay funds by a subsequent Act of Congress, the courts of the United States are without authority to order Congress to appropriate funds. The Agreement contemplates that it may be amended "as mutually determined by the Secretary of the Interior,

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18/ Id. at 188 (citations omitted).

19/ No. 87-5053 (D.C. Cir., Oct. 14, 1988).

20/ Id., slip op. at 46.

21/ Agreement, at 5 (citation omitted).

22/ P.L. 99-396 at 100 Stat. 841, reprinted in 48 U.S.C.A. § 1681 at 551 (1987).

or his designee, and the Government of the Northern Mariana Islands." [23] Thus, to the extent that it is not inconsistent with the implementing legislation, the Secretary has authority to amend the Agreement. [24]

The Agreement also states that "the full faith and credit authorization and appropriation of the capital development funds . . . as provided in Part II, paragraph 3(c), shall not be subject to such amendment." [25] This provision may remove authority from the Secretary to modify certain portions of the Agreement, but for domestic law purposes, modification by later Act of Congress cannot be foreclosed. It is not only a non-justiciable political question, but also the later provision of law controls notwithstanding our earlier guarantee of payment to the CNMI.

III. NATURE OF OBLIGATION OF THE UNITED STATES

The United States by the latest operative statute has made:

> a commitment and pledge of the full faith and credit of the United States for the payment of $228 million at guaranteed annual amounts of direct grant assistance for the Government of the Northern Mariana Islands for an additional period of seven fiscal years . . . which assistance shall be provided according to the schedule of payments contained in the Agreement. . . [26]

Thus, since the appropriations have been made by Congress, this is a binding commitment of the United States to pay the $ 228 in installments set by the Agreement. The Secretary of the Interior was expressly denied the authority to withhold any funds from the CNMI. [27] Because the judicial review provisions in the earlier Compact of Free Association

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[23] Agreement, Part III, ¶ 2, at 5.

[24] See supra text at n. 16.

[25] Agreement, Part IV at 5.

[26] P.L. 99-396 reprinted at 100 Stat. 840.

[27] See P.L. 99-396 at 100 Stat. 841.

Act, [28] waive the sovereign immunity of the United States, and make the obligations enforceable in court, CNMI may properly seek mandamus in the Claims Court against the Secretary of the Interior to order the Secretary to disburse any funds that are being withheld unlawfully. This is an explicit and permissible waiver of sovereign immunity. [29] However, if Congress by subsequent legislation expressly withholds funds, then notwithstanding the terms of the Agreement or implementing legislation, [30] the courts of the United States must enforce the latest legislation as prevailing United States law. Even if Congress originally intended to have the money come from the judgment fund, later legislation explicitly removing the rememdy cannot be foreclosed.

The withholding of funds may be a permissible exercise of the authority of the United States to withhold funds by Act of Congress. But, this may only be done for violation of the terms of the Agreement. The Agreement clearly contemplates that the CNMI must comply with the terms of the Agreement. If CNMI does not comply, then by Act of Congress the funds may be withheld by the United States without violation of the Agreement. However, if the funds are withheld for reasons other than those provided for in the Agreement, [31] then the United States would be in violation of the Agreement for both domestic and international law purposes. Nevertheless, because withholding can only be accomplished by an Act of Congress, no justiciable question

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[28] "The obligation of the United States under Articles I and III of this Title shall be enforceable in the United States Claims Court or its successor court, which shall have jurisdiction in cases arising under this Section, notwithstanding the provision of 28 U.S.C. 1502, and which court's decisions shall be reviewable as provided by the laws of the United States." Section 236, reprinted at 99 Stat. 1819. The accompanying legislative history indicates that Congress intended that judgments "would be paid under 31 U.S.C. 1304," the judgement fund. See 1976 U.S.CODE CONG. & ADMIN. NEWS at 2770.

[29] A mandamus remedy lies under 28 U.S.C. § 1361 because the statute imposes a non-discretionary duty to disburse funds upon the Secretary. Normally, such a claim is not enforceable in the Claims Court, see 28 U.S.C. § 1502, but, this provision is statutorily waived. See supra note 28.

[30] P.L. 99-396.

[31] Whether the Agreement is considered to be an international agreement in the nature of a congressional-executive agreement, or simply domestic statutory law.

arises as to which law is controlling since the most recent law trumps any earlier obligation. 32/

1. Meaning of Full Faith and Credit

The Agreement, Covenant, and relevant appropriations legislation state in various manners that the payments shall be accorded the "full faith and credit of the United States." This term is not defined in any of the underlying records. 33/ The term full faith and credit, other than in a different context in the Constitution, 34/ has almost exclusively been used in the context of United States guarantee of bonds. This language has never been implied to mean that express conditions on payment cannot be enforced. That is, the obligation of the United States can be conditioned on compliance with conditions implicit in the guarantee. 35/ Because this was a solemn obligation of the United States, Congress specifically exempted certain payments to the Northern Mariana Islands from automatic sequestrations pursuant to the Gramm-Rudman-Hollings deficit reduction requirements. 36/ However, the fact that Congress provided an

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32/ See Committee of United States Citizens Living in Nicaragua v. Reagan, No. 87-5053 (D.C. Cir. Oct. 14, 1988).

33/ Other than as reference in P.L. 99-239, which states:

> this obligation will be discharged in the same manner as other financial obligations incurred through international agreements requiring an act of appropriation, the FAS are provided with a judicial remedy before the U.S. Claims Court in the event payments owing under the compact are not made. Because the compact will be both an international agreement and public law, this is a valid grant of jurisdiction . . . .

See 1976 U.S.CODE CONG. & ADMIN NEWS at 2769-70. But this provision does not in any way define the meaning of full faith and credit. Rather it only provides for an explicit waiver of sovereign immunity.

34/ U.S. CONST. art. IV, § 1.

35/ See e.g., Brunswick Bank & Trust Co. v. United States, 707 F.2d 1355 (Fed. Cir. 1983).

36/ Joint resolution to approve the Covenant . . . and an Act to authorize appropriations for certain insular areas of the United States, . . . there

(continued...)

exemption, does not imply that Congress was required to provide an exemption. The Presidential Signing statement of H.R. 2478, specifically espouses the position of the President that notwithstanding full faith and credit obligations, specific programs should not automatically be protected from Gramm-Rudman-Hollings. 37/ The fact that Congress specifically acted to exempt the full faith and credit obligations from automatic sequestration pursuant to Gramm-Rudman-Hollings, supports the position that notwithstanding declarations of full faith and credit, or the guarantee of payment, the payments may be reduced by subsequent legislation. Otherwise passage of this specific exemption would have been unnecessary. It is a fundamental tenet of statutory interpretation that provisions of statutes should be read in pari materia. 38/

> The terms of the Agreement provide specifically that
>
> the full faith and credit for the payment of government operations funds shall be subject to the performance standards (paragraph 4 of this Part) and settlement of disputes provisions paragraph 2 of Part III) contained in this agreement. 39/

These particular provisions which make the full faith and credit of the United States subject to certain performance standards are not inconsistent with the statutory appropriations language. Only inconsistent obligations are superseded by later statutes addressing the same topic. 40/ The United States continues to

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> 36/(...continued)
> shall be paid into the treasur[y of] the Northern Mariana Islands . . . the full amounts which are to be covered into the treasur[y] of said islands or paid pursuant to said laws as amended and supplemented and such amounts shall not be reduced, notwithstanding Public Law 99-177, Public Law 99-366, or any other provision of law. H.R. 2478, P.L. 99-396, § 19(b), reprinted in 1986 U.S.CODE. CONG. & ADMIN. NEWS at 100 Stat. 844 (emphasis added).

37/ 22 WEEKLY COMP. PRESID. DOC 1125, Sept. 1, 1986.

38/ See supra quoted passage at n. 16. See also Schor v. Commodity Futures Trading Comm'n, 740 F.2d 1262 (D.C. Cir. 1984) (Laws should not be construed to conflict but rather should be construed harmoniously where that can reasonably be done.)

39/ Agreement, Part II, ¶ 1, at 1-2.

40/ See supra n. 16.

guarantee the payment of the funds so long as these performance standards are met. Thus, the conditions are not inconsistent with those in the Agreement and are fully operative.

The Department of the Interior thus has the right to reject the Commonwealth's Capital Development Plan on any grounds that are provided for in Part II.3 of the 1985 Agreement, and to monitor compliance with the performance standards provided for in Part II.2 of the Agreement. The terms of the appropriation specifically state that "[p]ursuant to section 701 of the foregoing Covenant, enactment of this section shall constitute a commitment and pledge of the full faith and credit of the United States . . ." [41] Section 701 provides that:

> The Government of the United States will assist the Government of the Northern Mariana Islands in its efforts to achieve a progressively higher standard of living for its people as part of the American community and to develop the economic resources needed to meet the financial responsibilities of local self-government To this end, the United State [sic] will provide direct multi-year financial support . . . . [42]

Insistence on compliance with performance standards does not involve a question of local self-government at all, but rather one of compliance with a contractual undertaking. The CNMI understood that the financial assistance was conditional and thus when the plebiscite was voted upon and approved, the CNMI necessarily understood that compliance would not be inconsistant with local self-government.

Specifically, part II.3 of the Agreement provides for a mutually agreed upon seven-year strategic plan for capital improvement. Thus, compliance necessarily requires the agreement of the Secretary of the Interior. Furthermore, Part II.4 of the Agreement conditions the payment of operations funds upon compliance by the CNMI with performance standards. The Agreement was signed by duly appointed representatives of both the CNMI and the President of the United States. The Agreement was further ratified by the Northern Marianas Commonwealth Legislature, [43] as well as by the United States. [44] Although not legally

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41/ P.L. § 10, 99-396, reprinted in 1986 U.S.CODE CONG. & ADMIN NEWS at 100 Stat. 840.

42/ § 701, reprinted in 48 U.S.C.A. 1681 at 545 (1987) (emphasis added).

43/ House Joint Resolution No. 5-4. CNMI.

44/ P.L. 99-396.

binding, the following passage excerpted from a letter written by Governor Tenorio of the CNMI is certainly persuasive that the CNMI was not unaware of the conditional nature of the United States financial commitments.

> We recognized that the level of funding in the future Financial Assistance Agreement was predicated on certain terms and conditions mutually agreed upon by the CNMI and the Department of the Interior's Office of Territorial Affairs and we stand committed to fulfill these obligations to the best of our ability. It has always been our intention to comply with the terms and conditions of the future Financial Assistance Agreement. As I indicated in my letter of July 15, 1986, we have already satisfied some of the terms of the Agreement and are in varying stages of compliance on others. 45/

Thus, despite the fact that the United States pledged its full faith and credit to the payment of the money, nevertheless, this pledge is properly subject to conditions expressly reserved in the signed Agreement. 46/ Furthermore, our pledge to "assist" the "efforts" of the CNMI to develop its economy to the extent necessary for "local self-government" cannot be construed to be a mandatory obligation to assure "self-government." 47/ Rather, that initiative is properly left to the

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45/ Letter from Governor Tenorio to Senators McClure and Johnston, Aug. 13, 1986.

46/ Some provisions may have been superseded to the extent they are inconsistent with the later implementing statute.

47/ Specifically the Agreement provides:

> II. 1. Full Faith and Credit. After approval of this Agreement by the Congress and the President of the United States, payments under this second multi-year financial assistance agreement shall be accorded the full faith and credit of the United States, except that the full faith and credit for the payment of government operations funds shall be subject to the performance standards (paragraph 4 of this Part) and settlement of disputes provisions paragraph 2 of Part III) contained in this agreement.
>
> * * *

(continued...)

people of the CNMI and their locally elected Representatives. There is simply no basis in the law of the United States for the CNMI to contend that monitoring for compliance with the terms of the Agreement is in any way inconsistent with their right to self-government. Furthermore, even if compliance makes local self-governance more difficult, the Supreme Court has held in the related field of Federal-State relationships that:

> [r]equiring States to honor the obligations voluntarily assumed as a condition of federal funding before recognizing their ownership of funds simply does not intrude on their sovereignty. The State chose to participate . . . and, as a condition of receiving the grant, freely gave its assurances that it would abide by the conditions . . . 48/

The concurring opinion of Justice White further states:

> The States entered into contractual-type agreements with the United States to disburse the moneys in accordance with specified conditions. The States had no legitimate claim to a right to be able to breach these agreements with impunity. 49/

The CNMI's right to local self-government does not even extend to the same level as the several states. In fact, although the status of all Commonwealths are not co-equal, but rather subject

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47/ (...continued)

> II. 2. When appropriated, funds shall be granted annually . . . according to such regulations as are applicable to such grants.
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> * * *
>
> 4. Government Operations. The full faith and credit of the United States for the payment of government operations funds shall be subject to fulfillment of the following performance standards during the entire seven-year period.
>
> * * *

Agreement at Part II, ¶¶ 1, 2 & 4. (emphasis added).

48/ Bell v. New Jersey, 461 U.S. 773, 790 (1983).

49/ 461 U.S. at 794.

to the terms contained in their respective agreements with the United States, the following interpretation of the rights of the Commonwealth of Puerto Rico is illustrative. The Court has held that:

> Congress, which is empowered under the Territory Clause of the Constitution, U.S. Const., Art. IV, § 3, cl. 2, to "make all needful Rules and Regulations respecting the Territory . . . belonging to the United States," may treat Puerto Rico differently from States so long as there is a rational basis for its actions. 50/

Thus, even if we assume arguendo that certain limitations on federal funding could possibly infringe upon state sovereignty, these limitations do not apply to the CNMI so long as there is a rational basis for the limitation. The need to assure proper use of federal funds for the attainment of local self-government through cooperative agreement is certainly a rational basis for Congress to act.

IV. JUSTICIABILITY

Finally, even assuming arguendo that the United States is in breach of its full faith and credit obligations to the CNMI, the courts are without competence to resolve this issue. The reason is that courts do not have the power to force Congress to pass appropriations legislation. It is a non-justiciable political question because: the Constitution textually commits certain questions to the political branches of the government; 51/ the meaning of full faith and credit has no legally definable standard which renders the court incompetent to resolve this essentially political dispute and; federal courts should prudentially abstain from rendering political judgments that would be difficult to enforce, the appropriation of money from the Treasury is explicitly delegated to Congress. 52/ Furthermore, it is settled law that as between inconsistent statutory or congressional-executive agreement provisions the

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50/ Harris v. Rosario, 446 U.S. 651 (1980) (emphasis added).

51/ To the extent that breach of the Covenant may affect our stature in the international community and thus the foreign relations of our government. See U.S. CONST., art II, § 2.

52/ U.S. CONST. Art. I, § 9, cl. 7. These three strands of the political question doctrine arise from Justice Brennan's classic formulation of the doctrine in Baker v. Carr, 369 U.S. 186, 218 (1962); see also Powell v McCormack, 395 U.S. 486, 518-49 (1969).

courts are not free to choose which must prevail, rather they must enforce the latest in time. 53/

53/ Whitney v. Robertson, 124 U.S. 190 (1888).