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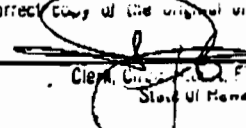
IN THE CIRCUIT COURT OF THE FIRST CIRCUIT
STATE OF HAWAII

In the Matter of the Estate)	Equity No. 2048
)	
of	)	FINDINGS OF FACT,
	)	CONCLUSIONS OF LAW,
Bernice P. Bishop,	)	AND ORDER GRANTING THE
	)	ATTORNEY GENERAL'S REQUEST
Deceased.	)	FOR INTERIM REMOVAL OF
	)	HENRY HAALILIO PETERS
	)	AND RICHARD SUNG HONG
	)	WONG, TRUSTEES UNDER THE
	)	WILL AND OF THE ESTATE OF
	)	BERNICE PAUAAHI BISHOP,
	)	DECEASED
)	
	)	Evidentiary Hearing:
	)	March 29, 1999
)	
	)	Judge: Colleen K. Hirai

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER GRANTING THE ATTORNEY GENERAL'S REQUEST FOR INTERIM REMOVAL OF HENRY HAALILIO PETERS AND RICHARD SUNG HONG WONG, TRUSTEES UNDER THE WILL AND OF THE ESTATE OF BERNICE PAUAAHI BISHOP, DECEASED

An evidentiary hearing was held on the Attorney General of the State of Hawaii's (hereinafter "Attorney General") request for interim removal of Henry Haalilio Peters and Richard Sung Hong Wong, Trustees under the Will and of the Estate of Bernice Pauahi Bishop, Deceased (hereinafter individually "Peters" and "Wong"), pursuant to the Petition for Approval of the One Hundred Ninth Annual Account filed on January 18, 1996, Petition for Approval of the One Hundred Tenth Annual Account filed on May 15, 1996, and

I do hereby certify that this is a true and correct copy of the original on file in this office.


Clerk, Circuit Court of the First Circuit
State of Hawaii

Petition for Approval of the One Hundred Eleventh Annual Account filed on May 15, 1997, commencing on March 29, 1999, before Judge Colleen K. Hirai. The Attorney General was represented by Deputy Attorneys General Hugh R. Jones and Daniel A. Morris. Peters was represented by attorneys Renee M. L. Yuen and Gari Ann Baptista. Wong was represented by attorneys Glenn K. Sato and Kenneth M. Nakasone. The Court having considered all of the evidence that was admitted at the evidentiary hearing, having reviewed the record, pleadings, and other written submissions, and having heard the arguments of counsel, hereby makes the following Findings of Fact, Conclusions of Law, and Order Granting the Attorney General's Request for Interim Removal of Henry Haalilio Peters and Richard Sung Hong Wong, Trustees under the Will and of the Estate of Bernice Pauahi Bishop, Deceased.

FINDINGS OF FACT

1. On October 31, 1883, Princess Bernice Pauahi Bishop (hereinafter "Princess") of Honolulu, Island of Oahu, Hawaiian Islands, executed the Will of Bernice Pauahi Bishop (hereinafter "Will").

2. The Princess' Will provides in part:

Thirteenth. I give, devise and bequeath all of the rest, residue and remainder of my estate real and personal, wherever situated unto the trustees below named, their heirs and assigns forever, to hold upon the following trusts, namely: to erect and maintain in the Hawaiian Islands two schools, each for boarding and day scholars, one for boys and one for girls, to be known as, and called the Kamehameha Schools. I direct my trustees to expend such amount as they may deem best, not to exceed however one-half of the fund which may come into their hands, in the purchase of suitable

premises, the erection of school buildings, and in furnishing the same with the necessary and appropriate fixtures furniture and apparatus. I direct my trustees to invest the remainder of my estate in such manner as they may think best, and to expend the annual income in the maintenance of said schools; meaning thereby the salaries of teachers, the repairing buildings and other incidental expenses; and to devote a portion of each years income to the support and education of orphans, and others in indigent circumstances, giving preference to Hawaiians of pure or part aboriginal blood; the proportion in which said annual income is to be divided among the various objects above mentioned to be determined solely by my said trustees they to have full discretion. I desire my trustees to provide first and chiefly a good education in common English branches, and also instruction in morals and in such useful knowledge as may tend to make good and industrious men and women; and I desire instruction in the higher branches to be subsidiary to the foregoing objects. For the purposes aforesaid I grant unto my said trustees full power to lease or sell any portion of my real estate, and to reinvest the proceeds and the balance of my estate in real estate, or in such other manner as to my said trustees may seem best. I also give unto my said trustees full power to make all such rules and regulations as they may deem necessary for the government of said schools and to regulate the admission of pupils, and the same to alter, amend and publish upon a vote of a majority of said trustees. I also direct that my said trustees shall annually make a full and complete report of all receipts and expenditures, and of the condition of said schools to the Chief Justice of the Supreme Court, or other highest judicial officer in this country; and shall also file before him annually an inventory of the property in their hands and how invested, and to publish the same in some Newspaper published in said Honolulu; I also direct my said trustees to keep school buildings insured in good Companies, and in case of loss to expend the amounts recovered in replacing or repairing said buildings....

Fourteenth. ... I direct that a majority of my said trustees may act in all cases and may convey real estate and perform all of the duties and powers hereby conferred; but three of them at least must join in all acts. I further direct that the number of my said trustees shall be kept at five; and that vacancies shall be filled by the choice of a majority of the Justices of the Supreme Court,....

3. On October 4, 1884, the Princess executed Codicil No. 1.

4. Codicil No. 1 provides in part:

17th I give unto the trustees named in my will the most ample power to sell and dispose of any lands or other portion of my estate, and to exchange lands and otherwise dispose of the same; and to purchase land, and to take leases of land whenever they think it expedient, and generally to make such investments as they consider best; but I direct that my said trustees shall not purchase land for said schools if any lands come into their possession under my will which in their opinion may be suitable for such purpose; and I further direct that my said trustees shall not sell any real estate, cattle ranches, or other property, but to continue and manage the same, unless in their opinion a sale may be necessary for the establishment or maintenance of said schools, or for the best interest of my estate. I further direct that neither my executors, nor trustees shall have any control or disposition of any of my personal property, it being my will that my husband, Charles R. Bishop, shall have absolutely all of my personal property of every description. And I give unto my executors named in my said will full power to sell any portion of my real estate for the purpose of paying debts or legacies without obtaining leave of Court; and to give good and valid deeds for the same, the purchasers under which are not to be responsible for application of the purchase money.

5. On October 9, 1884, the Princess executed Codicil No. 2.

6. On January 18, 1996, the Petition for Approval of the One Hundred Ninth Annual Account (hereinafter "109th Account") was filed for the period from July 1, 1993 to and including June 30, 1994, by the Trustees under the Will and of the Estate of Bernice Pauahi Bishop (hereinafter collectively "Trustees").

7. On January 18, 1996, an Order of Reference to Master was filed appointing Colbert M. Matsumoto (hereinafter interchangeably "Matsumoto" or "Master") as the Master to review the 109th Account.

8. On May 15, 1996, the Petition for Approval of the One Hundred Tenth Annual Account (hereinafter "110th Account") was filed for the period from July 1, 1994 to and including June 30, 1995 by the Trustees.

9. On June 6, 1996, Matsumoto was appointed as the Master to review the 110th Account.

10. On May 15, 1997, the Petition for Approval of the One Hundred Eleventh Annual Account (hereinafter "111th Account") was filed for the period from July 1, 1995 to and including June 30, 1996 by the Trustees.

11. On August 19, 1997, Matsumoto was appointed as the Master to review the 111th Account.

12. Peters and Wong were Trustees who filed the 109th, 110th, and 111th Accounts and were Trustees during the period covered by these Accounts.

13. On November 17, 1997, Matsumoto filed the Master's Report on the One Hundred Ninth Annual Account of the Trustees (hereinafter "109th Report").

14. On December 3, 1997, the Trustees' Response to Master's Report on the One Hundred Ninth Annual Account was filed.

15. On December 19, 1997, a Stipulation Concerning Master's Recommendations (109th Annual Account) and Order was filed (hereinafter "109th Stipulated Order").

16. The 109th Stipulated Order authorized the Master to commission a full financial and management audit to assist him and to provide information and guidance to the parties.

17. The financial and management audit was suggested by the Trustees.

18. Pursuant to the 109th Stipulated Order, the Stipulation Concerning Financial and Management Audit was filed on January 9, 1998.

19. The Stipulation resulted in the selection of Arthur Andersen LLP (hereinafter "Andersen") by the Master to perform the financial and management audit.

20. On August 7, 1998, the Master's Consolidated Report on the One Hundred Ninth, One Hundred Tenth, and the One Hundred Eleventh Annual Accounts of the Trustees (hereinafter "109th, 110th, and 111th Consolidated Report") was filed which included references to the audit performed by Andersen.

21. On August 7, 1998, the Kamehameha Schools Bernice Pauahi Bishop Estate Management Audit Findings - July 1998 (hereinafter "Andersen Report") prepared by Andersen was filed under seal and later unsealed with the exception of certain pages.

22. On September 9, 1998, the Attorney General's Response to Master's Consolidated Report on the 109th, 110th, and 111th Annual Accounts (hereinafter "Attorney General's Response") was filed.

23. The Attorney General's Response included a request for interim removal of the Trustees based on the Master's findings.

24. On September 9, 1998, the Trustees' Response to Master's Consolidated Report on the One Hundred Ninth, One Hundred Tenth, and the One Hundred Eleventh Annual Accounts of the Trustees (hereinafter "Trustees' Response") was filed.

25. On September 10, 1998, the Petition of the Attorney General on Behalf of the Trust Beneficiaries to Remove and Surcharge Trustees, for Accounting and for Other Equitable Relief was filed.

26. On September 29, 1998, the Master's First Supplemental Report on the One Hundred Ninth, One Hundred Tenth, and the One Hundred Eleventh Annual Accounts of the Trustees (hereinafter "First Supplemental Report") was filed.

27. On September 29, 1998, the Trustees' Objection to Attorney General's Response to Master's Consolidated Report on the 109th, 110th, and 111th Annual Accounts was filed.

28. On September 29, 1998, the Reply of the Attorney General to Trustees' Response to Master's Consolidated Report was filed.

29. On October 2, 1998, Stipulations Concerning Master's Recommendations (109th, 110th, and 111th Annual Accounts) and Order (hereinafter "109th, 110th, and 111th Stipulated Order") was filed.

30. On December 2, 1998, the Order Regarding the Petitions for Approval of the 109th, 110th, and 111th Annual Accounts was filed and an evidentiary hearing on the Attorney General's request for interim removal of the Trustees was scheduled on the regular probate calendar.

31. On February 16, 1999, the Attorney General's Pre-Hearing Statement for Removal of Trustees (hereinafter "Attorney General's Pre-Hearing Statement") was filed regarding the evidentiary hearing on the Attorney General's request for interim removal.

32. In the Attorney General's Pre-Hearing Statement, the Attorney General requested the interim removal of Peters and Wong as well as Trustees Marion Mae Lokelani Lindsey and Gerard Aulama Jervis (hereinafter individually "Lindsey" and "Jervis") but did not request the interim removal of Trustee Oswald Kofoad Stender (hereinafter "Stender").

33. The Attorney General's request for interim removal related to (1) nonsegregation of income and corpus accounts, (2) reclassification of \$350,000,000.00 from the income account to the corpus account, (3) accumulation of income in the amount of \$350,000,000.00, (4) utilization of the lead trustee system, (5) Hamakua land purchase, and (6) payment of fee commission based on final disbursement of capital. ✓

34. Trustee Henry Haalilio Peters' Prehearing Statement Re: Interim Removal of Trustees was filed on March 2, 1999.

35. Trustee Richard Sung Hong Wong's Interim Removal Pre-Hearing Statement was filed on March 2, 1999.

36. The hearing on interim removal as to Lindsey and Jervis was continued and an evidentiary hearing proceeded as to the claims against Peters and Wong only on March 29, 1999.

A. Segregation of Income and Corpus.

37. The Princess' Will requires that the Trustees annually make a full and complete report of all receipts and expenditures, annually file an inventory of the property and how it is invested.

38. The Report of the Attorney General with Respect to the 81st Annual Account of Bernice Pauahi Bishop, Deceased for the

Period Covering July 1, 1965 Through June 30, 1966, filed on February 10, 1970, stated in part:

2. Regarding the Master's criticism that the accounts fail to properly reflect the financial position of the Bernice P. Bishop Estate, the Attorney General concurs in the Master's finding that the schedule of receipts and disbursements do not reflect income cash flow and corporate (sic) cash flow separately. Such failure to properly segregate the cash account between income cash and corpus cash makes it difficult, if not impossible, to distinguish between capital expenditures from operating expenses without retracing each expenditure to a chart of accounts. As was noted by the Master (pp. 4-8), the Trustees' failure to account separately for income cash flow and corpus cash flow makes it almost impossible to determine whether proper commissions have been charged by the Trustees during the period.

....

11. The Trustees further should be required to segregate accounts as between income and corpus and not only in equity accounts as previously done (discussed on pages 37-38 by Mr. Sasaki).

39. On June 2, 1970, the Trustees filed the Exceptions to the Report of the Attorney General on the 81st Report of the Trustees and specifically objected to the Attorney General's recommendation "14. That the trustees should be required to segregate accounts as between income and corpus (Report, para. 11)."

40. On July 22, 1970, a Stipulation was filed based on an informal conference on the Exceptions of the Trustees to the Report of the Attorney General on the 81st Account which provided:

1. That a satisfactory arrangement has been agreed upon between the Trustees and the Attorney General which will meet the requirements of the Attorney General in future accountings of the matters referred to in Exceptions ... 14.

41. The Order Approving 81st Annual Account was filed on July 30, 1970, and the account was approved subject to the July 22, 1970 Stipulation.

42. For eighteen years following the filing of the Order Approving the 81st Annual Account until the 103rd Annual Account, the Trustees filed financial statements that segregated the income account from the corpus account and provided the status of accumulated income.

43. Without giving notice, beginning with the 103rd Annual Account (hereinafter "103rd Account") for fiscal year 1988, the financial statements submitted by the Trustees no longer segregated the income account from the corpus account.

44. Robert Bruce Graham, Jr. (hereinafter "Graham") is an attorney who has represented Kamehameha Schools/Bishop Estate (hereinafter "KSBE") since 1973.

45. Graham has filed the annual accounts for KSBE since 1985.

46. Although the exact terms of the "satisfactory arrangement" referred to in the July 22, 1970 Stipulation are not clear, Graham acknowledged that after the Order Approving the 81st Annual Account was filed, the annual accounts were segregated between the income account and corpus account for the next eighteen years.

47. Peters and Wong rely on the Order Establishing Minimum Guidelines for Future Masters and Instructing Trustees Concerning Future Annual Reports (hereinafter "Minimum Guidelines") filed on

May 4, 1988, as the reason that the income account and corpus account were no longer being segregated.

48. The Minimum Guidelines state that they superseded all prior orders concerning the form and content of the annual reports, but do not affect any prior order construing the Trust or determining the powers and authority of the Trustees.

49. Graham was involved in the preparation of the Minimum Guidelines.

50. Graham testified that no consideration was given to the form of the accounts when the Minimum Guidelines were prepared and that the Minimum Guidelines do not provide any specific requirements regarding the form of financial statements.

51. The Stipulation for Amendment and Restatement of Amended Guidelines (hereinafter "Amended Guidelines") was filed on October 4, 1995.

52. The Amended Guidelines also relate to the form and content of future accounts.

53. Graham was also involved in the preparation of the Amended Guidelines.

54. Graham stated that there was no discussion about the format of the financial statements during the preparation of the Amended Guidelines and that the Amended Guidelines do not require that the financial statements be prepared using a specific method of accounting.

55. Graham disagreed with Peters and Wong's reliance on Frank W. Hustace, Jr.'s (hereinafter "Hustace") Master's Report on the

Eighty-Fifth Annual Report of the Trustees (covering the period July 1, 1969 to and including June 30, 1970) filed on June 10, 1976, and stated that it does not address the issue of segregation of accounts.

56. William Holder (hereinafter "Holder"), a Certified Public Accountant and Professor of Accounting at the University of Southern California, testified that management is responsible for all information contained in financial statements.

57. Holder stated that Peters and Wong are members of management who are responsible for the financial statements.

58. Holder stated that management is responsible for both the Coopers and Lybrand, and Andersen financial statements.

59. Steven Bateman (hereinafter "Bateman"), a Certified Public Accountant and partner at PricewaterhouseCoopers, confirmed that it is management's responsibility to prepare the financial statements.

60. The Master made the following recommendation in the 109th, 110th, and 111th Consolidated Report:

**RECOMMENDATION NO. 2: CORPUS AND REVENUE ACTIVITY
SHOULD BE SPECIFICALLY REPORTED.**

Your Master recommends that the Trustees provide an explanation to the Court in their response to this Report why the prior order of the Court requiring segregation of the corpus account and the revenue account was not complied with.

Your Master further recommends that the Trustees be ordered to annually submit financial statements which conform to the trust accounting format as prescribed in the Andersen Report beginning with the 112th Annual Account.

61. In the 109th, 110th, and 111th Stipulated Order, Peters and Wong stipulated and the Court ordered that the Trustees were to report the income account and corpus account separately beginning with the 112th Annual Account.

62. The reporting format used by the Trustees in the financial statements after the 103rd Account did not segregate the income account and corpus account.

63. The 109th, 110th, and 111th Accounts were not segregated as required by prior Court Order.

B. Accumulated Income.

64. On June 29, 1988, Nathan Aipa (hereinafter "Aipa"), General Counsel of KSBE, provided Rodney Park (hereinafter "Park"), the Controller of KSBE at that time, with a legal opinion as to whether accumulated income may be transferred to the corpus account.

65. Aipa informed Park that the Will and Codicils suggest that the transfer of accumulated income to the corpus account would be permissible.

66. Aipa recommended that if accumulated income was transferred to the corpus account, it should be earmarked specifically for maintenance or operations of the schools and that any uncertainties could be resolved by the Court.

67. Beginning on June 30, 1988, which was effective as of July 1, 1987, unexpended income from the income or revenue account was reclassified and put in the corpus account.

68. This procedure was followed to and including the 109th, 110th, and 111th accounting periods.

69. On June 15, 1998, the Master sent Graham a letter as a follow-up to his request of April 15, 1998 for information on accumulated income.

70. Graham responded to the Master's inquiry in writing on June 16, 1998 and stated that there was an accumulated income balance of \$48,850,349.00 in 1986, and a total amount of accumulated income of \$347,638,099.00 as of June 30, 1997.

71. Graham's letter indicated that Wallace Chin (hereinafter "Chin") had reviewed the records of KSBE which disclosed that prior to July 1, 1987, the corpus fund and accumulated income fund were separately maintained.

72. As of July 1, 1987, the accumulated income balance of \$65,629,805.00 was transferred to the corpus account.

73. On June 28, 1998, Graham sent another letter to the Master stating that the accumulated income total through June 30, 1997 was \$349,319,132.00 rather than the figure of \$347,638,099.00 that was previously given.

74. According to Graham, the increase was due to the reclassification of a capital loss on a subsidiary's investment.

75. The Master included the latest figure provided by Graham for accumulated income in the Consolidated Report.

76. During the 109th, 110th, and 111th accounting period, the net cost of operating the education program was \$79,634,476.00 for 1994, \$90,709,601.00 for 1995, and \$87,612,035.00 for 1996.

77. In the Consolidated Report, the Master recommended the following:

RECOMMENDATION NO. 4: AN ACCOUNTING OF ACCUMULATED INCOME AND INDEPENDENT VERIFICATION SHOULD BE CONDUCTED.

Your Master recommends that the Trustees be ordered to provide an accounting to your Master within 60 days regarding the full extent of the accumulation of income by the Trust Estate and that such accounting be subject to independent review and verification by Arthur Andersen LLP.

78. In the 109th, 110th, and 111th Stipulated Order, Peters and Wong stipulated and the Court ordered the following as to accumulated income:

Stipulation No. 4: An Accounting of Accumulated Income And Independent Verification Shall Be Provided.

The Trustees shall provide to the Master an accounting of all accumulated income within 60 days from the date upon which the Court enters its order approving this Stipulation. The Master shall cause the Trustees' accounting to be reviewed and verified by Arthur Andersen LLP and shall report that firm's conclusions to the Court.

79. The most accurate figure for accumulated income that Graham has given to the Master pursuant to the 109th, 110th, and 111th Stipulated Order is \$335,000,000.00+.

80. The KSBE staff took several weeks to calculate this figure.

81. According to Graham, the difference in the figures provided to the Master resulted from the changes in accounting procedure necessitated by the 109th, 110th, and 111th Stipulated Order, which required the use of consolidated accounting system.

82. Randall Chang (hereinafter "Chang"), the General Manager of the Asset Management Group, started working at KSBE in that position on August 3, 1998.

83. According to Chang, the purpose of the Asset Management Group is to provide money or funding to operate Kamehameha Schools and its various campuses and their mission is to earn money.

84. Chang testified that accumulated income is nothing more than the leftover income after expending income for expenses and it is often referred to as retained earnings.

85. Chang indicated that accumulated income is a part of retained earnings which becomes a part of net worth.

86. Chang stated that these funds are put into a large pool and "it's not as if you can identify a specific amount and track it and what has become of it".

87. Chang stated that the amount of investments that are made can be tracked "but whether or not you can source those investments back to the accumulated income is very difficult because it is just a pool of funds."

88. Chang could not identify what portion of the accumulated income was specifically invested in real estate, marketable securities, or anything else.

89. Chang does not know the exact amount of accumulated income that exists.

90. Holder does not believe accumulated income is a term of art but defines it as income from the inception to a particular

point in time or reporting date that has not been expended, and it is what has been accumulated over the years.

91. Holder stated that accumulated income represents the aggregation of the excess of revenue over expenses for all of the years of operation less any years in which there was an excess of expenses over revenue.

92. To calculate the amount of accumulated income, Holder stated that you would go back to a point where you know what that number is and add the successive amounts of excesses of revenue over expenses deducting for an excess of expenses over revenue.

93. According to Holder, accumulated income under the Will is the excess of revenue over expenses cumulative for years and years.

94. Bateman testified that he could calculate the total amount of accumulated income quickly using certain financial statements.

95. Bateman stated that by using his computer it would take him approximately one-half hour to provide the total amount of accumulated income to the end of the fiscal year 1996.

96. Bateman did not calculate or provide the Court with the total amount of accumulated income.

97. The accumulated income that was transferred to the corpus account was not earmarked as Aipa had recommended.

98. The procedure used by Peters and Wong in accumulating income resulted in the inability to readily and accurately determine the accumulated income balance.

99. Peters and Wong did not disclose the total amount of accumulated income in the 109th, 110th, and 111th Accounts.

C. Expenditure of Accumulated Income.

100. In the Report of the Master on the Petition of the Trustees of the 99th Annual Report filed on August 2, 1985, the Master for the 99th Account recommended that the Trustees continue to prepare and amend the Ten-Year Plan incorporating a long-range plan demonstrating the expenditure of accumulated income for educational purposes.

101. In the Findings of Fact, Conclusions of Law and Order Approving the 99th Annual Report filed on October 8, 1985, the Court ordered the following:

3. The Trustees are directed that they shall continue to prepare, implement and from time to time amend and revise their Ten-Year Plan, incorporating therein long-range planning for the expenditure of accumulated income for educational purposes consistent with said Will.

102. In the Master's Report on the One Hundred Fifth Annual Report of the Trustees filed on April 21, 1992 and the Master's Report on the One Hundred Sixth Annual Report of the Trustees filed on September 8, 1993, the Master recommended the development of a Strategic Plan (both short-term and long-term) to coordinate the "revenue generating" and "educational spending" roles of KSBE.

103. In the Findings of Fact, Conclusions of Law and Order Approving 105th Annual Report that was filed on June 8, 1992, the Court noted that the Trustees concurred with the Master and that an effort was in progress to prepare a Strategic Plan.

104. In the Findings of Fact, Conclusions of Law and Order Approving 106th Annual Report that was filed on December 27, 1993, the Court noted that the Trustees concurred with the Master and that strategic planning was ongoing.

105. The Master's Report on the One Hundred Seventh Annual Report of the Trustees and Master's Report on the One Hundred Eighth Annual Report of the Trustees filed on September 15, 1995 incorporated the Master's recommendations contained in the 105th Report and restated in the 106th Report with additional comments.

106. The Findings of Fact, Conclusions of Law and Order Approving 107th and 108th Annual Reports filed on February 9, 1996 provided in part:

b. **Strategic Plan.** That the Trustees continue to balance the desire to expand the scope of educational services with the realities of the cost of expanded services and facilities, bearing in mind the realistic long term projected revenue generating capacity of the Trust Estate; and that the Trustees' Strategic Plan clearly establish responsibility and accountability for performance;.....

107. Matthew Lincoln (hereinafter "Lincoln") is one of the managing directors of Cambridge Associates (hereinafter "Cambridge"), the largest consulting firm that advises nonprofit endowed institutions.

108. Lincoln is the primary consultant for KSBE from Cambridge.

109. Lincoln began working with KSBE in 1983 and has provided advice to KSBE on the overall management of KSBE's investment objectives and asset allocation.

110. Cambridge prepared reports on November 29, 1983, February 2, 1987, March 12, 1996, and September 16, 1997.

111. The 1983 and 1997 reports were comprehensive asset allocation studies.

112. Before 1997, Lincoln was not aware that Peters and Wong had been ordered by the Court to plan for the expenditure of accumulated income.

113. Lincoln confirmed that Cambridge would have been able to assist in developing a plan for the expenditure of accumulated income if asked, but Cambridge had not been asked to do so up to and including these accounting periods.

114. Aaron Au (hereinafter "Au") has been the Director of the Financial Asset Division at KSBE for eleven years.

115. In his position, Au is responsible for overseeing the financial assets and ten year financial projections.

116. Au has participated in discussions with Cambridge about KSBE's asset allocation plans for years.

117. Au is not familiar with the prior Court Orders requiring the Trustees to plan for the expenditure of accumulated income and did not have discussions with Cambridge about those Orders.

118. Randall Ho (hereinafter "Ho") is a Certified Public Accountant and principal with Ernst & Young in Honolulu, Hawaii, who worked with KSBE from January, 1994 through May, 1998 on various engagements including the GoForward Initiative (hereinafter "GoForward").

119. The model for GoForward that was accepted by the Trustees resulted in the elimination of certain educational programs and the operating cost of the project was budget neutral.

120. Ho did not determine when the operating cost of GoForward would no longer be budget neutral.

121. Ho testified that Ernest & Young was not asked to plan for the expenditure of accumulated income, but Ernst & Young would have been able to do so if asked.

122. Paul Ahr (hereinafter "Ahr") is the President of Corporate Psychology Center who has worked as a consultant for Ernst & Young since 1986.

123. Ahr began working with KSBE in 1991 or 1992 and after 1993 worked for several years on a strategic planning process for KSBE with Ernst & Young.

124. Ahr was not involved in any discussions involving the expenditure of accumulated income.

125. Ahr has not worked on KSBE's ten-year financial plan and does not know if it provides for the expenditure of accumulated income.

126. Yukio Takemoto (hereinafter "Takemoto") has been the Director of the Office of Budget and Review at KSBE since 1995.

127. Takemoto's responsibilities include overseeing the coordination of the budget, capital planning, and program review.

128. Takemoto was involved in the implementation of GoForward, which he described as an expansion program developed in 1995 to provide more opportunities for students.

129. Takemoto was not aware of the Court's prior Orders requiring the Trustees to plan for the expenditure of accumulated income.

130. Chang was not aware of the Court's prior Orders requiring the Trustees to plan for the expenditure of accumulated income and was only aware of the 109th, 110th, and 111th Stipulated Order.

131. In the Master's Consolidated Report, the Master recommended the following:

RECOMMENDATION NO. 5: STRATEGIC PLANNING SHOULD INCORPORATE EXPENDITURE OF ACCUMULATED INCOME.

Your Master recommends that the Court order the Trustees to undertake an appropriate strategic planning process under the supervision of the Court (as described in more detail in Part IX, Section A of this Report) which incorporates planning for the expenditure of the accumulated income.

132. In the 109th, 110th, and 111th Stipulated Order, Peters and Wong stipulated and the Court ordered:

Stipulation No. 5: Strategic Planning Shall Incorporate Planning for Expenditure of Accumulated Income.

The Trustees' strategic planning process, which is described more fully below, shall incorporate planning for the expenditure of accumulated income.

133. Peters and Wong did not plan for the expenditure of accumulated income.

D. Lead Trustee.

134. Park, who is presently the Director of the Administration Group at KSBE, stated that there was a lead trustee system at KSBE when he first joined KSBE in 1985.

135. Park testified that Peters was the lead trustee of the Asset Management Group, Lindsey was the lead trustee of the Education Group, Jervis was the lead trustee of the Legal Group, and Stender was the lead trustee for the Alumni.

136. Peters was the lead trustee for Asset Management Group following the death of Tony Sereno in 1995 or 1996 until Chang was hired on or about July, 1998.

137. In the Master's 109th Report, the Master made the following recommendation as to the existing lead trustee system:

RECOMMENDATION NO. 11 - "LEAD TRUSTEE" SYSTEM TO BE DISCONTINUED:

Your Master recommends that the Court instruct the Trustees to discontinue any informal practice of designating "lead Trustees". Instead, the Trustees should ensure that the "board" system of administration along with the formally established hierarchical scheme of management, through the hiring of properly selected and supervised agents, be kept intact and uncircumvented.

138. In the Trustees' Response to the Master's Report on the One Hundred Ninth Annual Account filed on December 3, 1997, the Trustees confirmed that a lead trustee system was being utilized.

139. To address the Master's recommendation that the lead trustee system should be discontinued, the 109th Stipulated Order included Recommendation No. 11 which required that the Trustees "review and act upon the organizational structure and governance of the Trust Estate in light of applicable principles of law and their individual and collective fiduciary obligations."

140. In the Master's Consolidated Report, the Master recommended that the lead trustee system should be abolished in Recommendation No. 14.

141. The Trustees' Response indicated that the lead trustee system had already been terminated, Lindsey had relinquished her role in August, 1997, and Peters had withdrawn as Interim General Manager of the Asset Management Group when Chang became the General Manager on August 3, 1998.

142. Graham testified that the Trustees' had previously represented that the lead trustee system had been discontinued as of August, 1997.

143. In the 109th, 110th, and 111th Stipulated Order, the Trustees stipulated and the Court ordered that the Trustees cease employing the lead trustee system of management.

144. The lead trustee system of management was being used throughout the 109th, 110th, and 111th accounting periods.

145. Although Peters and Wong previously stipulated and the Court ordered that the lead trustee system be terminated, the system continued to be used until July or August, 1998.

E. Hamakua Land Purchase.

146. A staff report was prepared by J. Melrose (hereinafter "Melrose Staff Report") for a meeting date of August 30, 1994 regarding the status of a pending auction of 30,500 acres of former Hamakua Sugar Company (hereinafter "Hamakua") land on the island of Hawaii.

147. The Melrose Staff Report did not provide any specific recommendation, but requested the Trustees' guidance.

148. The Melrose Report indicated that the Real Estate Investment and Appraisal Division (hereinafter "REIAD") of KSBE had

made a preliminary estimate of the value of the Hamakua property as \$550/acre or roughly \$15,000,000.00.

149. Kenneth Teshima (hereinafter "Teshima"), the Director of REIAD, indicated that he conducted an informal appraisal of the Hamakua property prior to its purchase.

150. Teshima did not prepare a formal written appraisal.

151. Teshima did not go out and physically look at the property before or after it was purchased.

152. Teshima testified that he conservatively appraised the Hamakua property at \$20,000,000.00.

153. The Melrose Report recommended against debt financing.

154. The Melrose Report provided in part:

The only advantage to KSBE of buying HSC's total land asset is that at the end of 20 years the investment would pay for itself and we would continue to hold 28,000 more acres of land in Hamakua. The economics of a direct land purchase would argue against bidding more than \$500.00 per acre since the lease income from forestry and pasture uses is insufficient to justify more up-front investment. So long as our investment is passive, even with debt financing, the acquisition should not result in negative tax consequences.

155. Robert Lindsey, Jr. (hereinafter "Robert Lindsey"), a Region Director for the Asset Management Group, Hawaii, Island region, was present when the Melrose Report was presented at the Trustees' meeting on September 1, 1994.

156. At the September 1, 1994 meeting, Robert Lindsey was told to get together with Peter Savio and report back.

157. Robert Lindsey reported back to the Trustees at the meeting on September 7, 1994.

158. At the September 7, 1994 meeting, Robert Lindsey was given authority to bid up to \$20,000,000.00 at the auction.

159. Robert Lindsey did not observe a vote being taken at that meeting.

160. At the September 22, 1997 Trustees' meeting, Robert Lindsey was given the authority to increase the purchase price to \$21,000,000.00.

161. No vote was taken at the September 22, 1994 meeting.

162. The Hamakua property was purchased by KSBE for \$21,000,000.

163. Minutes for the Trustees' meeting which authorized the purchase of the Hamakua property for \$21,000,000.00 have not been produced.

164. Graham testified that he does not believe there are any minutes documenting the decision to purchase the Hamakua property for \$21,000,000.00.

165. The Hamakua purchase was primarily debt financed.

166. Documentation supporting the decision to purchase the Hamakua property or to utilize debt financing has not been produced.

167. Although Peters and Wong anticipate that the leasing of the Hamakua property for timber or forestry will provide an estimated return of \$26,000,000.00 at the first harvest in 2003, the purchase of the Hamakua land resulted in a loss of \$4,800,000.00 for the fiscal years from 1994 through 1996.

168. Peters and Wong did not seek Cambridge's guidance on the purchase of the Hamakua land in 1994.

169. From 1984 to 1996, the Trustees' investment in non-core real estate increased.

170. Since 1983, Cambridge has consistently recommended that the Trustees de-emphasize the addition of non-core real estate.

171. The Master made the following recommendation as to the Hamakua purchase in the First Supplemental Report:

RECOMMENDATION NO. 20: THE TRUSTEES SHOULD ACCOUNT FOR AND HOLD THE TRUST ESTATE HARMLESS FROM THE HAMAKUA INVESTMENT.

Accordingly, your Master recommends that the Court order the Trustees to account for and be surcharged for such amounts as required to hold the Trust Estate harmless from losses associated with the investment in the Hamakua Lands.

172. Peters and Wong did not properly document the analysis supporting their investment decision to purchase the Hamakua land.

F. Final Disbursement of Capital.

173. On April 28, 1966, the Memorandum for the Confidential Files of the Trustees signed by four Trustees reflected that the full Board of Trustees voted to adopt the following resolution as a part of the settlement of issues raised by the Master's Report on the 79th Annual Account pursuant to discussions with the Attorney General:

1. "The Trustees determined that from and after January 1, 1966 they would take no commissions on taxes collected on leases of residential lands but would take commissions on taxes collected on leases of non-residential lands; and

2. "That from and after January 1, 1966 the Trustees would take no commissions on final payment involving construction of buildings and improvements at The Kamehameha Schools."

174. The Minutes of the May 12, 1966 meeting provided in part:

Statement on Trustees' Commissions: The Trustees voted to append to, and make a part of these Minutes, their statement relating to Trustees' commissions on taxes collected on residential leaseholds and final payments involving construction of buildings and improvements at The Kamehameha Schools.

175. In the Report of the Attorney General With Respect to Petition of Trustees for Approval of the 79th Annual Report, .Being for the Period from July 1, 1963 to June 30, 1964, Both Dates Inclusive filed on July 15, 1966, the Attorney General indicated that the Trustees agreed that commissions would not be paid on money borrowed or paid for construction of Kamehameha Schools facilities.

176. The Amended Order Approving 79th Annual Account filed on May 26, 1967, reflected the Court's approval of the account based on corrective adjustments undertaken by the Trustees.

177. In the Inter-Office memorandum from Chin to Peters dated June 3, 1994 regarding Trustees' commissions, Chin provided a summary of trustee commissions allowable by law as opposed to the current practice at KSBE.

178. In the Memo to trustee commission file providing instructions from Chin dated July 12, 1994, Chin confirmed that the Trustees rescinded their waiver of commissions on final disbursement of capital relating to payments towards non-revenue

generating assets including the education group capital projects, Kawaiahao Plaza renovation, and KSBE equipment.

179. Chin's instructions provided in part:

For information purpose, the waiver of commissions on final disbursements of capital began:

On August 25, 1959, on advice of J. Garner Anthony, Trustees voted "to refrain from taking capital commissions on final payments made in the development of properties for purposes on increased revenue inasmuch as there is no compulsion on the part of trustees to take all of the statutory commission in which they are entitled."

Appended to the minutes of May 12, 1966, the full Board of Trustees voted to adopt the resolution "that from and after 1/1/66 the trustees would take no commission on final payments involving construction of buildings and improvements at the Kamehameha Schools."

180. In the Trustees' Response Concerning the Computation of Trustee Commissions filed on February 11, 1998, the Trustees acknowledged having taken FDOC for the time period in question:

Final disbursement of capital ("FDOCs") - the commissions allowable in this category of capital disbursements have historically been waived. Each month the amount of FDOCs is determined, and the allowable commissions thereon are computed and then not included in the commission payment amount. During the period from August 26, 1993, through July 31, 1994, commissions were accepted on FDOCs. Effective August 1, 1994, express waivers were executed for commissions payable on final disbursements of capital.

181. The Master initially found that the commissions paid to the Trustees were calculated and paid in a manner consistent with KSBE's interpretation of statutory authority, but withdrew his finding as to the propriety of the manner in which the commissions were determined pending the receipt of additional information.

182. James Schwartz (hereinafter "Schwartz") is an attorney who worked in the Charitable Trust Enforcement Section of the Attorney General's Office in California for more than twenty years.

183. Schwartz reviewed the 79th Accounts for 1966 and testified that the waiver of FDOC commissions appeared to be based on an agreement between the Trustees and Attorney General, and was probably consistent with the settlement of that account.

184. Schwartz stated that his conditional opinion was that Peters and Wong should not have rescinded the prior Trustees' waiver of FDOC commissions and should not have taken the payments since it was based on an agreement.

185. Schwartz suggested that the proper remedy is to surcharge Peters and Wong for repayment of those funds and the Court should not allow the commissions.

186. Peters and Wong did not comply with the prior Court order by taking FDOC commissions.

G. May 7, 1999 Order.

187. In the Consolidated Report, the Master recommended the following:

RECOMMENDATION NO. 14: THE LEAD TRUSTEE SYSTEM SHOULD BE ABOLISHED AND A NEW CEO BASED MANAGEMENT SYSTEM SHOULD BE INSTITUTED AS RECOMMENDED BY THE ANDERSEN REPORT.

Your Master recommends that the Trustees be ordered to cease administering the Trust Estate based upon the "lead trustee" system of management. The Trustees should be further required to show cause in their response to this Report of why they should not be ordered by the Court to adopt and implement a CEO-based system of management for the Trust Estate as recommended in the Andersen Report within 180

days after the date on which the Court issues an order adopting this recommendation. Such a system should incorporate a formal governance policy which more clearly defines the roles of the Board of Trustees and that of the CEO.

188. The 109th, 110th, and 111th Stipulated Order provided in part:

Stipulation No. 14: A New CEO Based Management System Shall Be Instituted.

The Trustees shall cease to employ the "lead trustee" system of management in administering the Trust Estate.

The Trustees shall adopt and implement a CEO based system of management for the Trust Estate consistent with the concept recommended in the Andersen Report and hire a CEO within 180 days after the date on which the Court enters its Order approving this Stipulation. The system shall incorporate a formal governance policy which more clearly defines the roles of the Board of Trustees and that of the CEO. The role of the CEO shall be consistent with standards for delegation of authority under trust law.

The Master shall have full access to the Trustees to monitor and review the development of the CEO based management system, the formal governance policy, and the selection of the CEO, and may require such status reports and meetings as he reasonable sees fit.

The Trustees shall seek comment from the Master and the Attorney General, as *parens patriae*, regarding the CEO based management system and the formal governance policy and shall obtain the approval of the CEO based management system and formal governance policy from the Court, through a stipulation or order.

189. The deadline in Stipulation No. 14 in the 109th, 110th, and 111th Stipulated Order elapsed on March 31, 1999, but Peters and Wong did not comply with the terms prior to that date.

190. Graham confirmed that a CEO had not been appointed as of April 27, 1999.

191. On May 7, 1999, the Order Regarding Order to Show Cause Regarding Special Purpose Trustees' Report and Order to Show Cause

Regarding New CEO Based Management System (hereinafter "May 7, 1999 Order") was filed.

192. In that May 7, 1999 Order, Judge Kevin S. C. Chang temporarily removed Peters and Wong based on issues relating to the Internal Revenue Service and their failure to comply with Stipulation No. 14 of the 109th, 110th, and 111th Stipulated Order.

193. If any of the above findings of fact shall be deemed to be conclusions of law, the court intends that every such finding of fact shall be construed as a conclusion of law.

CONCLUSIONS OF LAW

1. The Probate Court has jurisdiction over the parties and subject matter of this proceeding.

2. The filing of a Petition to remove Peters and Wong on an interim basis is not required because the Court has jurisdiction over them since this proceeding arises out of the 109th, 110th, and 111th Accounts and Peters and Wong have been fully informed as to the issues presented. In re Holt, 33 Haw. 352 (1935).

3. The applicable standard of review is the standard used in a motion for temporary injunctive relief.

4. Applying that standard, the Court concludes that the Attorney General is likely to prevail on the merits of the claims presented, that the balance of irreparable harm favors the granting of the Attorney General's request for interim removal, and that the public interest supports the granting of the Attorney General's request for interim removal of Peters and Wong based on the breach

of their fiduciary duties as Trustees. Life of the Land v. Ariyoshi, 59 Haw. 156, 577 P.2d 1116 (1978).

5. The Court finds that the Court Orders of May 26, 1967, July 30, 1970, October 8, 1985, February 9, 1996, December 19, 1997, and October 2, 1998 are binding on Peters and Wong.

6. The Court concludes that Peters and Wong have violated these Court Orders.

7. The Court finds that the principle set forth in Section 554C-2 of the Hawaii Revised Statutes (hereinafter "HRS") of the Uniform Prudent Investor Act (hereinafter "Prudent Investor Rule") which includes the requirement that Peters and Wong make a reasonable effort to verify facts relevant to an investment and management of trust assets is binding on Peters and Wong.

8. The Court concludes that Peters and Wong have violated the principle set forth in the Prudent Investor Rule.

9. The Attorney General has demonstrated the likelihood of prevailing on the merits of the claims based on the Master's findings relating to (1) nonsegregation of income and corpus, (2) accumulated income, (3) lead trustee system, (4) Hamakua land purchase, (5) final disbursement of capital, and (6) CEO based management system.

10. The Court finds that the balance of irreparable harm favors the granting of the Attorney General's request based on Peters and Wong's conduct during the three accounting periods.

11. The removal of Peters and Wong through the May 7, 1999 Order is temporary and irreparable harm to KSBE will occur if the May 7, 1999 Order is no longer in effect.

12. The public interest in the continuity of KSBE necessitates the granting of the Attorney General's request.

13. The Court in the exercise of its discretion removes Peters and Wong on an interim basis effective immediately.

14. If any of the above conclusions of law shall be deemed to be findings of fact, the Court intends that every such conclusion of law shall be construed as a finding of fact.

ORDER

1. It is hereby ordered that in accordance with the foregoing Findings of Fact and Conclusions of Law, the Attorney General's request for interim removal of Peters and Wong is granted, and Peters and Wong shall be removed on an interim basis effective immediately on the filing of the Findings of Fact, Conclusions of Law, and Order Granting the Attorney General's Request for Interim Removal of Henry Haalilio Peters and Richard Sung Hong Wong, Trustees Under the Will and of the Estate of Bernice Pauahi Bishop, Deceased, to and including March 28, 2000, which is a period of one year from the commencement of the evidentiary hearing.

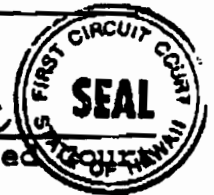
2. The interim removal shall be extended until the completion of the hearing on the Petition of the Attorney General on Behalf of the Trust Beneficiaries to Remove and Surcharge Trustees, for Accounting and for Other Equitable Relief filed on

September 10, 1998, if the hearing on that Petition is commenced by March 28, 2000.

3. The Attorney General may file a Petition to extend the period of interim removal and Peters and Wong may file a Petition regarding the period of interim removal if the hearing on the Petition of the Attorney General on Behalf of the Trust Beneficiaries to Remove and Surcharge Trustees, for Accounting and for Other Equitable Relief filed on September 10, 1998, is not commenced by March 28, 2000.

Dated: Honolulu, Hawaii, AUG 31 1999

Colleen K. Hirai
Judge of the Above-Entitled



Equity No. 2048, In the Matter of the Estate of Bernice P. Bishop Deceased., Findings of Fact, Conclusions of Law, and Order Granting the Attorney General's Request for Interim Removal of Henry Haalilio Peters and Richard Sung Hong Wong, Trustees under the Will and of the Estate of Bernice Pauahi Bishop, Deceased