FINAL VERSION
August 18, 1999

DEPARTMENT OF THE TREASURY - INTERNAL REVENUE SERVICE ESTATE OF BERNICE PAUAHI BISHOP, also known as, KAMEHAMEHA SCHOOLS BISHOP ESTATE CLOSING AGREEMENT ON FINAL DETERMINATION COVERING SPECIFIC MATTERS

Under Section 7121 of the Internal Revenue Code ("IRC"), Estate of Bernice Pauahi Bishop, also known as, Kamehameha Schools Bishop Estate ("KSBE") (Taxpayer Identification Number 99-0073480), with its principal offices located at Kawaiaha'o Plaza, 567 South King Street, Suite 200, Honolulu, Hawai'i, 96813; Kamehameha Activities Association ("KAA") (Taxpayer Identification Number 51-0190227), with its principal offices located at Kawaiaha'o Plaza, 567 South King Street, Honolulu, Hawai'i, 96813; and KAA acting as successor to Pauahi Holdings Corporation, Inc. ("PHC") (Taxpayer Identification Number 99-0288052), with its principal offices located at 2201 Kalakaua Avenue, Suite A500, Honolulu, Hawai'i 96815, on behalf of itself and as agent of those members of the consolidated group set forth at Attachment 1 (the "Consolidated Group"), and the Commissioner of Internal Revenue make the following Closing Agreement:

WHEREAS, on February 2, 1939, the Internal Revenue Service ("IRS") determined that KSBE was a tax exempt organization under Section 101(6) of the Revenue Act of 1938 (predecessor to IRC Section 501(c)(3)), which was reconfirmed by the IRS in a letter dated November 28, 1952;

WHEREAS, on April 16, 1969, the IRS concluded that KSBE was a tax exempt educational organization under IRC Section 501(c)(3);

WHEREAS, on November 9, 1970, the IRS determined that KSBE was a public charity under IRC Sections 509(a)(1) and 170(b)(1)(A)(ii), which was reconfirmed by the IRS in a letter dated September 10, 1986;

WHEREAS, on April 14, 1976, KAA received a determination letter from the IRS that KAA was recognized as a tax exempt charitable organization described in IRC Section 501(c)(3). Qn September 16, 1998, KAA received notification that the IRS recognized KAA as a supporting organization for KSBE under IRC Section 509(a)(3);

WHEREAS, on May 31, 1991, PHC was formed as a wholly-owned taxable subsidiary of KSBE to hold the stock of the taxable subsidiaries comprising the Consolidated Group;

WHEREAS, the IRS has conducted an examination (the "Tax Audit") of KSBE, KAA, PHC, and selected members of the Consolidated Group for all or part of the taxable periods ended June 30, 1990 through June 30, 1996. See Attachment 2.

WHEREAS, as used in this Agreement the term "KSBE Organizations" refers to KSBE and its subsidiary and supporting organizations including without limitation, KAA, PHC, and members of the Consolidated Group, and the term "KSBE" refers to the Trust Estate;

WHEREAS, as used in this Agreement the term "Incumbent Trustees" means Marion Mae Lokelani Lindsey, Henry Haalilio Peters, Richard Sung Hong Wong, Gerard Aulama Jervis, and Oswald Kofoad Stender who until May 7, 1999, were the appointed trustees of KSBE;

WHEREAS, the term "Will" means the last will and testament of Princess Bernice Pauahi Bishop who died in Honolulu, Hawai'i, and whose Will and two codicils were admitted to probate in the Supreme Court of the Hawaiian Islands on December 2, 1884;

WHEREAS, on January 4, 1999, KSBE received a series of draft IRS Forms 5701, Notice of Proposed Adjustments, that were issued to members of the KSBE Organizations containing the IRS's preliminary findings and conclusions on a variety of issues identified by the IRS in the course of and as a result of the Tax Audit (hereinafter the issues raised in the draft Forms 5701 and any other issues arising out of the Tax Audit will be referred to as the "Audit Issues");

WHEREAS, the draft Forms 5701 proposed revocation of KSBE 's tax exempt status retroactive to July 1, 1989, and also proposed a number of adjustments to the taxable income of KSBE;

WHEREAS, the IRS concluded that there was substantial evidence of private benefit and inurement of the net earnings of KSBE which benefited private individuals, including, but not limited to excessive compensation and perquisites paid to the Incumbent Trustees, sufficient to cause the IRS to revoke the exempt status of KSBE;

WHEREAS, the IRS concluded that there was substantial evidence of the operation of KSBE for a non-exempt purpose and, therefore, concluded that KSBE failed to engage in activities that primarily furthered KSBE's charitable purposes, sufficient to cause the IRS to revoke the exempt status of KSBE;

WHEREAS, the IRS also concluded that there was evidence of political campaign intervention by KSBE in violation of IRC Section 501(c)(3), which reflects a pattern of campaign intervention throughout the years examined by the IRS involving both Federal and state candidates for public office, including incumbents;

WHEREAS, the IRS concluded that unrelated business taxable income relating to credit enhancement revenue was not properly reported on KSBE's IRS Form 990-T during the taxable years 1992 through 1998;

WHEREAS, certain additional unrelated business taxable income was not properly reported on KSBE's IRS Form 990-T during the taxable years 1992 through 1996;

WHEREAS, certain amounts were omitted by KSBE on KSBE's IRS Forms 941 and 720 during the taxable years 1992 through 1996;

WHEREAS, under Haw.Rev.Stat. §554A-3(b) and under common law, the Incumbent Trustees have a duty not to exercise trust powers in a way to deprive KSBE of an otherwise available tax exemption, deduction, or credit for tax purposes;

WHEREAS, on January 21, 1999, the Master appointed by the Circuit Court of the First Circuit, State of Hawai'i ("Probate Court"), joined by KSBE's Tax Counsel and General Counsel, filed a report finding that the Incumbent Trustees of KSBE faced an apparent and actual conflict of interest in connection with the Tax Audit;

WHEREAS, on January 29, 1999, the Probate Court determined, after reviewing in camera the draft IRS Forms 5701, that the Audit Issues raised actual, apparent and potential conflicts of interest for the Incumbent Trustees and relieved the Incumbent Trustees of all trust powers to act for KSBE and the KSBE Organizations with respect to all issues involving or arising out of the IRS Audit;

WHEREAS, on February 16, 1999, the Probate Court appointed a panel of five Special Purpose Trustees, David Paul Coon, Francis Ahloy Keala, Ronald Dale Libkuman, Constance Hee Lau, and Robert Kalani Uichi Kihune ("Special Purpose or Interim Trustees"), "to exercise the trust power with regard to the issues raised by the IRS Forms 5701 and the pending IRS audit." Throughout this Agreement the term "Special Purpose or Interim Trustees" shall refer to the above five named individuals and their successors;

WHEREAS, the IRS, the Attorney General of the State of Hawai'i ("AG") in the AG's capacity as *parens patriae*, and the Probate Court's Master ("Master") have raised concerns with respect to the structure and future operations of the KSBE Organizations, resulting from: (1) the Master's review of KSBE's 109th through 111th Annual Accounts; (2) a comprehensive financial and management audit conducted by Arthur Andersen LLP; (3) the activities giving rise to the proposed revocation of KSBE's tax exempt status as set forth in the draft IRS Forms 5701; (4) events and disclosures occurring after the issuance of the draft Forms 5701; (5) the controversy occurring at the Kamehameha Schools that led to the permanent removal of Trustee Marion Mae Lokelani Lindsey; and (6) reports of court appointed fact-finders, accrediting bodies and management consultants that have examined the governance of KSBE;

WHEREAS, the Interim Trustees have also raised governance concerns relating to the future operation and structure of KSBE Organizations;

WHEREAS, the IRS and the Interim Trustees have engaged in a special consolidated procedure in an attempt to resolve all of the Audit Issues, including the proposed revocation of the tax exempt status of KSBE;

WHEREAS, the IRS has advised KSBE and the Interim Trustees that it will initiate a process to revoke KSBE's tax exempt status unless the trust governance concerns raised by the IRS are satisfactorily addressed;

WHEREAS, in two letters to the Special Purpose Trustees from the IRS dated April 19, 1999, and May 4, 1999, the IRS advised the Special Purpose Trustees that one of the conditions necessary to enter into and finalize this Closing Agreement to preserve the tax exempt status of KSBE is the permanent removal of the Incumbent Trustees;

WHEREAS, in an order filed May 6, 1999, and in findings of fact and conclusions of law filed June 17, 1999, the Circuit Court, First Circuit, State of Hawai'i permanently removed Marion Mae Lokelani Lindsey as a Trustee of KSBE concluding by clear and convincing evidence and found in part that Ms. Lindsey (1) violated the Will; (2) breached her duties of loyalty by using trust property for her own purposes; (3) breached her duty of care; (4) mismanaged the Trust; (5) breached her duty to use her special skills; (6) failed to use sound discretion; and (7) engendered hostility with the beneficiaries. The Circuit Court also found the other Incumbent Trustees had taken no action to address the concerns raised regarding Ms. Lindsey's mismanagement of the Kamehameha Schools;

WHEREAS, on May 7, 1999, the Probate Court ordered the interim removal of four of the Incumbent Trustees and accepted the interim resignation of the fifth Incumbent Trustee and relieved all of the Incumbent Trustees of all power and authority to exercise any trust power related to KSBE and the KSBE Organizations;

WHEREAS, in its May 7, 1999 order removing the Incumbent Trustees the Court found that the Incumbent Trustees' failure or refusal to resign in the face of possible revocation of KSBE's tax exempt status constituted a breach of duty and that the Incumbent Trustees had knowingly violated an order of the Court requiring KSBE to adopt and implement a CEO form of governance;

WHEREAS, on May 7, 1999, the Probate Court appointed the Special Purpose Trustees as Interim Trustees of KSBE and vested the Special Purpose Trustees "with full and complete discretion, power, and authority to exercise all trust power with respect to KSBE and its subsidiaries and affiliated organizations in a manner consistent with the Will of Bernice Pauahi Bishop and the Codicils thereto and subject to such duties, responsibilities, and fiduciary obligations as are imposed by law and under the Will of Bernice Pauahi Bishop and the Codicils thereto;"

WHEREAS, the IRS has advised KSBE and the KSBE Organizations that absent an agreement on the Audit Issues, as described in Part A below, the IRS will continue the proceedings to revoke the tax exempt status of KSBE, which KSBE then would be permitted to contest through applicable administrative and judicial proceedings;

WHEREAS, the Interim Trustees have concluded that: (1) the activities described in the draft Forms 5701's including the conduct of the Incumbent Trustees have placed the tax exempt status of KSBE at risk; (2) there would be a significant risk that KSBE's tax exempt status could be lost if the revocation issues were litigated; and (3) settlement of the Audit Issues under the terms set forth in this Closing Agreement, including permanent removal or resignation of the Incumbent Trustees, is necessary and appropriate to preserve the tax exempt status of KSBE and is in the best interests of KSBE;

WHEREAS, the Interim Trustees agreed to seek all necessary orders from the Probate Court to implement the terms of the Closing Agreement including permanent removal of the Incumbent Trustees;

WHEREAS, the Interim Trustees filed a petition with the Probate Court on August 24, 1999, seeking the permanent removal of the Incumbent Trustees;

WHEREAS, the Probate Court, following an evidentiary hearing, granted the Interim Trustees' petition for permanent removal of all of the Incumbent Trustees;

WHEREAS, the IRS recognizes that KSBE does engage in significant educational activities that are of the type described in IRC Section 501(c)(3);

WHEREAS, an appropriate settlement of the Audit Issues, including preservation of KSBE 's tax exempt status, will benefit KSBE and the charitable purposes of KSBE;

WHEREAS, by Order of the Hon. Kevin Chang, Judge, Probate Court 1st Circuit Court of Hawai'i, dated July 6, 1999, KAA and Ke Ali'i are subject to the same rules, regulations, and policies as those governing KSBE.

WHEREAS, by this same July 6, 1999, Order the Probate Court directed that the five KSBE Trustees be the sole directors of KAA and Ke Ali'i, and act solely in their capacities as Trustees of KSBE and not in their individual capacities. See Attachment 3.

WHEREAS, the Probate Court has continuing jurisdiction over KAA and Ke Ali'i and their assets in the same manner and to the same extent as its continuing jurisdiction over KSBE and its assets;

WHEREAS, the Interim Trustees and the KSBE Organizations have concluded that the interests of the KSBE Organizations will best be served by a resolution of the Audit Issues on the bases set forth in this Closing Agreement to avoid costly and time consuming litigation the outcome of which would be uncertain;

WHEREAS, the IRS also has concluded that it is in its best interests to resolve the Audit Issues on the bases set forth in this Closing Agreement, to ensure that KSBE will operate for educational and charitable purposes in compliance with IRC Section 501(c)(3), and as an educational organization described in IRC Section 170(b)(1)(A)(ii);

WHEREAS, KSBE has filed a supplemental appendix to its Form 1023 as a reaffirmation submission for continued status as an organization exempt from taxation under IRC Section 501(a) as described in IRC Section 501(c)(3), and for continued status as an educational organization described in IRC Section 170(b)(1)(A)(ii);

WHEREAS, the IRS found KSBE's reaffirmation submission to be acceptable and agreed to confirm KSBE's tax exempt status for all past periods and on a going forward basis subject to KSBE and the KSBE Organizations' compliance with this Closing Agreement;

WHEREAS, all of the Incumbent Trustees, namely Henry Haalilio Peters, Richard Sung Hong Wong, Marion Mae Lokelani Lindsey, Gerald Aulama Jervis, and Oswald Kofoad Stender, have resigned or been removed as Trustees of KSBE by the Probate Court;

WHEREAS, the Incumbent Trustees have resigned or been removed from all positions obtained by virtue of their status as Trustees of KSBE, or by virtue of KSBE's ownership, investment, control, or voting power with respect to any entity or organization;

WHEREAS, the Interim Trustees have provided the Probate Court with their views regarding a new process for selecting the Trustees of KSBE that would include an independent committee (hereinafter referred to as the "Nominating Committee") representing a diversity of interests. See Attachment 4;

WHEREAS, this Closing Agreement does not cover any IRC Section 4958 excise tax liability or any issues pertaining to IRC Section 4958 for any disqualified persons or organization managers associated with KSBE;

WHEREAS, the parties' agreements to resolve the Audit issues relating to the IRS's proposed revocation of KSBE 's tax exempt status are set forth in Part A below, the parties' agreements to resolve the Audit Issues regarding the non-revocation tax issues are set forth in Part B below, and the general agreements of the parties are set forth in Part C below;

NOW, THEREFORE, IT IS HEREBY DETERMINED AND AGREED for Federal income tax purposes that:

<u>Part A</u>: <u>**Resolution of Audit Issues Relating to KSBE 's Exempt Status**</u>:

1. KSBE and the KSBE Organizations agree to the following:

   A. In the event that any removal action of the Incumbent Trustees, namely Henry Haalilio Peters, Richard Sung Hong Wong, Marion Mae Lokelani Lindsey, Gerald Aulama Jervis, and Oswald Kofoad Stender, is set aside on appeal or by collateral attack and one or more of the Incumbent Trustees is reinstated as trustee of KSBE, this Closing Agreement shall be null and void in which event the procedures specified in paragraph A.1.Y.4. of this Closing Agreement will apply.

   B. To the extent the Incumbent Trustees continue to hold offices, directorships, memberships, consultative relationships, perquisites, or retain ex-officio status by virtue of their prior status as Trustees of KSBE, or by virtue of KSBE's ownership, investment, control, or voting power with respect to any entity or organization, or with respect to any position within the KSBE Organizations, the Interim Trustees or their successors will seek the resignation or removal of the Incumbent Trustees from such offices, directorships, memberships, consultative relationships, perquisites, or ex-officio status immediately upon discovery of said position;

C. Any business meetings regarding KSBE Organizations' business between either the Interim Trustees or Top Executives and the Incumbent Trustees must be documented in writing by the current KSBE official in attendance at said meeting, detailing the purpose of the meeting, the substance of the matters discussed, and the persons who attended said meeting, for the term of this Closing Agreement. The term "Top Executive" is defined herein as an "Organization Manager" within the meaning of IRC Section 4958(f)(2). The Interim Trustee or Top Executive will notify the IRS and AG of the meeting within 30 days of said meeting. The documentation of any meetings shall be available to the IRS and the AG upon request, within 30 days of said request.

D. KSBE agrees that the Trustees shall act as fiduciaries and exercise general oversight over the activities of the KSBE Organizations, but will not be involved in management of the day-to-day operations of the KSBE Organizations. The Trustees' primary focus is the furtherance of the educational purposes of KSBE, as set forth in Attachment 5.

E. KSBE will follow the procedures established by the State of Hawai'i for suspension or removal of trustees in the event a trustee fails to fulfill his or her duties and responsibilities. KSBE agrees that in the event that a Trustee engages in one or more activities listed in Attachment 6, the other Trustees will initiate suspension or removal proceedings in accordance with Hawai'i law.

F. The management structure of KSBE will initially be organized around a Chief Executive Officer. See Attachment 7 for current structure.

1. The Trustees will primarily establish the policies of KSBE and will exercise a fiduciary oversight role, consistent with the requirements of the Will, Probate Court orders regarding the administration of the Trust, and State of Hawai'i Trust law. The policies established by the Trustees will ensure that education is the primary focus of KSBE.

2. The Chief Executive Officer will independently carry out the policy decisions of the Board of Trustees.

3. KSBE agrees that the duties and responsibilities of the Chief Executive Officer are clearly defined and the individual(s) hired to fill this position will be person(s) with extensive experience in similar positions as enumerated in Attachment 8. The Trustees will perform annual performance reviews of the Chief Executive Officer. The CEO will review the performance of other Top Executives. These performance reviews will be made available to the Internal Auditor.

4. The IRS agrees that if, as a result of the strategic planning process described in paragraph I, an alternative management structure is recommended, the alternative management structure may be implemented by KSBE, with notice to the AG and prior approval by the Probate Court. KSBE will provide the IRS with a copy of

any petition seeking the Probate Court's permission to effectuate such structural or management changes. KSBE will notify the IRS, in writing, of any such changes approved by the Probate Court within 30 days of issuance of the Court approval.

G. KSBE agrees that the revised organizational structure of the KSBE Organizations referred to in paragraph F above, ensures that an adequate system of checks, balances, and affirmative disclosure requirements exists within the KSBE Organizations to provide safeguards against any abuse of power by the Trustees, individually or collectively, and any abuse of power by any Top Executives on the KSBE Organizations' staff, individually or collectively. Additionally, KSBE agrees to implement an adequate system of checks, balances, and affirmative disclosure requirements to provide safeguards against the mismanagement of Trust assets by the Trustees, or by any individuals or entities given access to said assets by the KSBE Organizations. The Trustees of KSBE in their capacity as Directors of any KSBE Organization will not actively participate in the day-to-day management or have effective management control over any of the KSBE Organizations. The KSBE Organizations agree to submit a report to the IRS and the AG within twelve months of the date of this Closing Agreement outlining the implementation of the above stated safeguards.

H. KSBE agrees that its Trustees and Top Executives are subject to a new Conflict of Interest Policy (see Attachment 9) to ensure appropriate compliance with fiduciary standards. The required financial disclosure statements will be made available to the AG and to the Master.

I. The KSBE Organizations have agreed to develop and implement a comprehensive educational and financial strategic plan, as ordered by the Probate Court on October 2, 1998, including investment policies. The strategic planning process will include an educational plan developed in conjunction with an investment plan, the principal focus of which is the furtherance of the educational mission of KSBE. The KSBE Organizations agree that this plan will be finalized and submitted to the IRS, to the AG and the Master no later than eighteen months from the date of this Closing Agreement. A copy of said plan shall also be filed by KSBE in the Probate Court.

J. The Interim Trustees have adopted an initial Investment Policy. KSBE agrees that its Investment Policy will be regularly updated by the KSBE Organizations, as warranted, to ensure that the investment objectives and vehicles are consistent with the educational objectives of KSBE, and will be incorporated as supplemental schedules to the KSBE Organizations' financial statements. Investment performance reports will be prepared and submitted by KSBE to the Probate Court with KSBE 's Annual Account. Such schedules will also be provided by KSBE to the IRS during the term of this Closing Agreement. A copy of said schedules shall be submitted by KSBE to the Probate Court, and to the Hawai'i Attorney General.

K. KSBE and the KSBE Organizations have developed and agree to follow a spending policy that focuses on the educational purpose of KSBE, as set forth in Attachment 10. The IRS agrees that KSBE may increase spending to directly serve the educational needs of children consistent with the Will and Probate Court orders regarding the administration of the Trust. At least annually, KSBE will publicly solicit written comments from the Hawaiian community concerning the developmental and educational needs of native Hawaiian children.

L. KSBE agrees that it will comply with the program approved by the Probate Court for setting Trustee compensation. See Attachment 11.

M. KSBE agrees to follow the methodology for determining the compensation of the Chief Executive Officer, as set forth in Attachment 12.

N. The KSBE Organizations will ensure that certified financial audits are prepared and filed annually with the Probate Court with the Annual Accounts of the KSBE Organizations. For the term of this Closing Agreement, these financial statements, including all supplemental schedules, will also be provided to the IRS, to the Hawai'i Attorney General, and made available to the general public upon request and by posting them on KSBE's Internet Web-site. These statements will be prepared in conformity with GAAP, unless otherwise approved in Court Orders and Stipulations by the Probate Court.

O. An independent internal audit function has been reimplemented within KSBE, as described in Attachment 8. In addition to its other functions, the independent Internal Auditor including the Auditor's staff members (hereinafter "Internal Auditor") will monitor the KSBE Organizations' compliance with the terms of this Closing Agreement, all Court orders and stipulations relevant to this Agreement, and adherence to the Conflict of Interest Policy set forth in Attachment 9. The Internal Auditor will annually report the results of his/her monitoring of KSBE's compliance with this Closing Agreement, all Court orders and stipulations relevant to this Agreement, and adherence to the Conflict of Interest Policy to the IRS as "Special Filings" during the term of this Closing Agreement. The Special Filings will be signed by the Internal Auditor under the penalties of perjury. The Special Filings will also be submitted by KSBE to the Master, and the Attorney General of the State of Hawai'i.

1. The KSBE Organizations have established procedures to ensure that the Internal Auditor and any individuals within the KSBE Organizations providing information to the Internal Auditor will not be subject to intimidation, or detrimental or retaliatory actions as a result of their activities. Such protections will be announced and affirmed in a resolution of the Board of Trustees and communicated to all employees on an annual basis. The Internal Auditor or any other employee having knowledge that there has been a violation of this policy shall immediately report to the AG, the IRS and the Master any actions that violate this policy by KSBE, its Trustees, the KSBE Organizations, and their agents and employees.
2. The Internal Auditor will have immediate and unrestricted access to all records irrespective of their physical form and will be able to interview all employees of KSBE and the KSBE Organizations at the Auditor's request. The attorney/client privilege and/or other privileges will not be asserted by KSBE or the KSBE Organizations to prevent disclosure of any records to the Internal Auditor or access to any individuals by the Internal Auditor.

3. The Internal Auditor will be paid an annual salary set by the Board of Trustees, and may be removed or reassigned only for just cause by a majority of the Board of Trustees;

4. In the event the Internal Auditor finds that a trustee or Top Executive has failed to comply with the Conflict of Interest policy, the Internal Auditor will report any apparent conflicts to the Board of Trustees for appropriate action. The Board of Trustees will communicate in writing to the Internal Auditor the action or actions resulting from the Internal Auditor's report to the Board of Trustees, within 30 days of the action. The Internal Auditor will also include in the Special Filing provided for in Paragraph O, above, the actions taken by the Board of Trustees, if any, in response to the Internal Auditor's report to the Board of Trustees of an apparent or actual conflict of interest.

P. KSBE has undertaken a review of existing contractual, consultative, employment, and professional service relationships in existence as of June 30, 1999 to ensure that the services provided under such contracts or through such relationships are necessary to the operation of the KSBE Organizations, that the prices and/or compensation paid for such services are reasonable and commensurate with services rendered, and that they are not in violation of any of the terms of this Closing Agreement. Retainer fees were subject to special scrutiny for propriety. KSBE shall report the results of this review to the IRS, the Master, and the AG within twelve months of the date of this Closing Agreement. A copy of said report shall also be filed with the Probate Court.

Q. KSBE and the KSBE Organizations have reviewed all significant job classifications in existence as of June 30, 1999 to ensure that the job positions and compensation for such positions are appropriate for the accomplishment of KSBE's exempt purpose and that the individuals occupying such positions are qualified to perform the responsibilities of the position. KSBE shall report the results of this review to the IRS, the Master, and the AG within twelve months of the date of this Closing Agreement. A copy of said report shall also be filed with the Probate Court.

R. KSBE and the KSBE Organizations agree to follow their standard procurement practices policy, attached as Attachment 13, to ensure that contracts for goods and services will be awarded on the basis of open and competitive bidding, and that exceptions to competitive bidding will be specifically defined, as set forth in Attachment 13.

S. KSBE and the KSBE Organizations will establish employment and contractual procedures ensuring, prospectively, that contractual and employment relationships are necessary and appropriate and that the prices and/or compensation paid for services are reasonable. A report of said procedures shall be submitted by KSBE to the IRS and the AG within twelve months of the date of this Closing Agreement. A copy of said report shall be filed by KSBE with the Probate Court.

T. KSBE and the KSBE Organizations agree that they will follow the policy of not employing, reimbursing, or paying for the services of (including office expenses of), an elected or appointed member of the legislative, judicial, or executive branches of government, whether state, federal, or local. (This provision does not apply to non-compensated positions on advisory commissions or boards unless service on such a board or commission would violate KSBE's Conflict of Interest policy.) In no case shall KSBE or the KSBE Organizations employ such an individual, until a period of three years has passed since the individual's status as an appointee or elected official with the governmental entity has terminated, unless KSBE has received the express approval of the Probate Court. Notwithstanding the above, Robert Herkes, an incumbent legislator employed by KSBE may serve the remainder of his term in the Hawaii legislature which expires November, 2000, but will not thereafter serve in the legislature while employed by KSBE or the KSBE Organizations and will otherwise be subject to the foregoing paragraph.

U. The KSBE Organizations have established procedures which will ensure the proper and complete documentation of all educational, investment and management decisions made by the Board of Trustees and by the Top Executives, and retention of said documentation. The Board of Trustees' minutes will contain documentation to indicate the Trustees present at the meeting and will contain a record of the matters voted on, in addition to the acceptance or rejection of the particular matter. Any staff reports presented prior to or during a meeting of the Board will be attached and filed with the appropriate minutes. Any Resolutions passed will be attached and filed with the appropriate minutes. In all instances in which these documents concern matters relating to the administration of the Trust, or a Trustee's fiduciary obligations or duties, or the Trustees' fiduciary responsibilities as Trustees, these documents will be readily available upon request for inspection and copying by IRS personnel, by the Hawai'i Attorney General's office, as *parens patriae*, or by the Probate Court, without assertion of privileges.

V. The KSBE Organizations will not engage in any prohibited political intervention, as defined in the IRC Section 501(c)(3) and the implementing Regulations.

W. KSBE agrees that within 6 months of the date of this Closing Agreement, KSBE will adopt a lobbying policy that will include requirements for documenting communications with state and federal legislators, legislative offices and committees on matters relating to the financial, administrative, business, or educational affairs of KSBE or the KSBE Organizations. Documentation of any such communications will be made available to the Master, the AG, and the IRS.

X. Any entity in which KSBE has or acquires an ownership interest of more than 50 percent, or any controlling interest in any organization, whether taxable or tax exempt, shall be considered a part of the KSBE Organizations for purposes of this Agreement. This includes any subsidiary or related organization organized under foreign law. Any passive investments, for example a passive investment in a limited partnership, will not be considered a part of the KSBE Organizations for purposes of this Closing Agreement, with the following exceptions:

1. Any compensation paid to Trustees or Top Executives by an entity that is involved in a passive investment of KSBE or the KSBE Organizations must be reported to the IRS and the AG in the annual Internal Auditor's Special Filing referenced in Paragraph O of this Closing Agreement;
2. Any passive investments must be included in the FMV of the Trust Endowment for purposes of the annual Trust Spending Rate.

Y. If the IRS believes there has been a material breach of any of the terms of this Closing Agreement, the following immediate actions will occur:

1. A Notice from the Internal Revenue Service will be mailed to KSBE and to the AG, informing KSBE that the IRS has become aware of an apparent material breach of the Closing Agreement. Any Notice under this paragraph shall contain an explanation of the alleged breach and a statement of the facts on which the allegation is based, and will provide KSBE with 30 days in which to respond, in writing, to the allegations;
2. Within 60 days of the date of KSBE's response, the IRS will afford KSBE the opportunity to have a conference with the IRS;
3. If the information presented at the conference does not satisfy the concerns of the Service, the Service shall so notify KSBE in writing and this agreement shall become null and void.
4. If this Closing Agreement becomes null and void for any reason, the IRS may issue a proposed revocation letter, proposing to revoke KSBE's tax exempt status. KSBE shall have full administrative rights to contest any proposed IRS revocation action and proposed tax adjustments under established IRS procedures and shall have any judicial remedies provided by law.

* * *

Part B: Settlement of Tax and UBIT Issues

1. KSBE agrees to a settlement of Nine Million Dollars for payment in lieu of Federal taxes or deficiencies thereof, additions to tax, and penalties for the tax years ended June 30, 1992, through June 30, 1996. KSBE agrees to a payment of (insert amount of interest through date of payment) dollars for interest on the above stated settlement, calculated as of the date of execution of this Closing Agreement. This settlement includes the tax liability with respect to the "credit enhancements issue" through June 30, 1998. The "credit enhancements issue" relates to all fees paid or accrued during 1997 and 1998 under agreements similar in nature to those in issue in the Forms 5701 Issue No. B-IA and Issue No. B-IC, by which KSBE agreed to extend its creditworthiness to third parties, such arrangements including, but not limited to, note repurchase agreements, securing letters of credit, and otherwise providing guarantees of payment. This settlement amount will be paid in full within five working days of the date on which this Closing Agreement is executed. Payment will be by wire transfer to an account to be specified by the IRS.

2. The Commissioner agrees that the above stated amount shall satisfy the obligation of KSBE to the Commissioner for the tax years ended June 30, 1992, through June 30, 1996, and that no other amounts will be asserted as owed to the Commissioner by KSBE for those tax years. This amount includes an excise tax under IRC Section 4955 for political intervention during the taxable years 1992 through 1996.

3. KSBE agrees that for Federal tax purposes KSBE will not attempt to amortize, deduct, or otherwise try to recover from the Commissioner any of the Nine Million dollars settlement made pursuant to this Closing Agreement and that, except as provided below, none of the payment made pursuant to this Closing Agreement is amortizable, deductible, or otherwise recoverable on any Federal tax return. KSBE further agrees that KSBE will not receive any Federal tax benefit on account of the Nine Million Dollar settlement made pursuant to this Closing Agreement. Nothing in this paragraph is intended to preclude the deduction of (insert dollar amount of interest) as interest.

4. Nothing in this Closing Agreement shall preclude or prohibit the Commissioner from examining KSBE or any member of the KSBE Organizations for taxable years ending June 30, 1997, or later, except that such examination shall not take place with respect to unrelated business taxable income issues relating to credit enhancements for the taxable years ending June 30, 1997 through June 30, 1998. In the event this Closing Agreement becomes null and void for any reason, the statute of limitations will be deemed to have been extended for three years from the date this agreement becomes null and void for all taxable years. KSBE agrees that Forms 872, Consents to Extend the Time to Assess Tax, with respect to liability for income tax for KSBE and tax exempt subsidiaries for the years included in the Tax Audit will be executed on the same date that this closing agreement is executed.

5. The KSBE Organizations and the IRS agree that the attorney- client privilege applies to communications with counsel for the purpose of receiving legal advice.

   a. The KSBE Organizations agree that there will be no presumption of attorney-client privilege, or any other privilege, arising from the mere presence of an attorney in the KSBE Organizations' conduct of business for purposes of its subsequent dealings with the IRS.

   b. The KSBE Organizations agree that the attorney-client privilege, or any other privilege, does not arise when counsel performs services other than providing legal advice.

   c. The KSBE Organizations agree that the attorney-client privilege will not apply to facts, documents, materials, or information merely because such items are shared, circulated or coordinated with counsel and for which no legal opinion is requested.

6. Neither the IRS nor KSBE Organizations shall endeavor by litigation or other means to attack the validity of this Closing Agreement, absent fraud, malfeasance or misrepresentation of material fact.

7. This Closing Agreement does not cover any income tax, employment tax or excise tax liabilities of the non-tax exempt entities including corporations, partnerships, limited liability companies and limited liability partnerships of the KSBE Organizations.

<u>Part C</u>

1. The IRS agrees that in lieu of revocation, the IRS will accept KSBE's supplemental appendix to its Form 1023 as a reaffirmation submission requesting continued recognition as an organization exempt from taxation under IRC Section 501(a) as described in IRC Section 501(c)(3). The reaffirmation submission will be treated as part of KSBE's current exemption application for purposes of IRC Section 6104 and Section 301.6104(a)-1(d) of the Procedure and Administrative Regulations. The IRS agrees that it has reaffirmed KSBE's exempt status, as indicated by letter dated.

2. This Closing Agreement and Attachments will be made available to the public by KSBE in the KSBE Office located at Kawaiaha'o Plaza, 567 South King Street, Suite 200, Honolulu, Hawai'i, 96813, and on the KSBE Internet Web-site upon the signing of said Agreement.

3. KSBE agrees that it will file with the IRS all documents required by reason of this Closing Agreement by sending said documents to the Chief EP/EO, 300 North Los Angeles Street, Mail Stop 7000, Los Angeles, CA 90012-3335 or his/her successor, and a copy to the Director, Exempt Organization Division, 1111 Constitution Ave. N.W., Washington, D.C. 20224 or his successor.

4. The term of this Closing Agreement shall be for five years after the signature date.

5. Nothing in this Closing Agreement is intended to amend, modify, or vacate any prior order of the Probate Court regarding the administration of the Trust.

6. This Closing Agreement does not affect the rights, duties or powers of the AG as *parens patriae* of charitable trusts in the State of Hawai'i, nor affect the common law duties of *parens patriae*.

7. This Closing Agreement is final and conclusive, except that:

a. The matter it relates to may be reopened in the event of fraud, malfeasance or misrepresentation of a material fact;

b. It is subject to the Code sections that expressly provide that effect be given to their provisions (including any stated exception for IRC Section 7122) notwithstanding any other law or rule of law; and

c. It is subject to any law enacted after this Closing Agreement is signed that applies to a taxable period ending after the date the Closing Agreement is signed.

By signing, the parties certify that they have read and agreed to the terms of this document.

For and on behalf of:

Estate of Bernice Pauahi Bishop, also known as, Kamehameha Schools Bishop Estate, Kamehameha Activities Association, KAA as successor to Pauahi Holdings Corporation, Inc. and its Consolidated Group.

By ________________________________ Date Signed ____________
Robert K. U. Kihune, Chair, Interim Trustees

______________________________________ Date Signed ____________
David P. Coon, Interim Trustee

______________________________________ Date Signed ____________
Francis A. Keala, Interim Trustee

______________________________________ Date Signed ____________
Constance H. Lau, Interim Trustee

______________________________________ Date Signed ____________
Ronald D. Libkuman, Interim Trustee

Commissioner of Internal Revenue

By ______________________________ Date Signed ____________

Title ______________________________

I have examined the reporting requirements to the Hawai'i Attorney General and agree that these reporting requirements are in the best interests of the Trust and the State of Hawai'i.

____

Attorney General (Date)
State of Hawai'i

1

ATTACHMENT 1

KSBE AND KSBE ORGANIZATIONS

Kamehameha Schools Bernice Pauahi Bishop Estate

Ke Ali'i Pauahi Scholarship Fund

Kamehameha Activities Association

Bishop Holdings Corporation

Kamehameha Investment Corporation

P&C Insurance Company, Inc.

Pauahi Management Corporation

Paki, Inc.

Water Works, Inc.

Keauhou Community Services, Inc.

Kukui, Inc.

VCI, Inc.

KDP Limited

KBH, Inc.

RTJ Limited Liability Company

Gwinnett Associates Limited Liability Company

Lake Manassas Limited Liability Company

Shelter Bay Limited Liability Company

Horton Grove Limited Liability Company

Treyburn Limited Liability Company

Paradise Petroleum, Inc.

Kukui Operating Company

2

ATTACHMENT 2

SUPPORT INCOME TAX EXAMINATION –

The income tax examination of Pauahi Holdings Corporation and Subsidiaries included the consolidated corporate tax return, Form 1120, for the following tax periods ended:

June 30, 1992
June 30, 1993
June 30, 1994
June 30, 1995
June 30, 1996

Within the consolidated group, the following subsidiaries were selected for the audit:

Pauahi Holdings Corporation, parent holding company
Royal Hawaiian Shopping Center, Inc.
Accessory Place, Inc.
Nationwide Industries, Inc.
Snap Products, Inc.
Hanford's, Inc.
Hanford's Creations, Inc.
P & C Insurance Company, Inc.
Kukui, Inc.
Kamehameha Investment Corporation (limited issue only – Form 4797)

Related partnership returns, Form 1065 which were audited included:

RTJ Acquisition Limited Partnership (Year ended June 30, 1996)
Benson Forests Limited Partnership (Years ended June 30, 1995 and 1996)

ROBERT BRUCE GRAHAM, JR. 1305-0
ASHFORD & WRISTON
Alii Place, Suite 1400
1099 Alakea Street
Honolulu, Hawaii 96813
Telephone No.: 539-0400

Attorney for Petitioners,
The Trustees under the Will and of the
Estate of Bernice Pauahi Bishop, Deceased

FIRST CIRCUIT COURT
STATE OF HAWAII
FILED

1999 JUL -6 PM 3:28

D. SAKIMOTO
CLERK

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

In the Matter of the Estate of BERNICE P. BISHOP, Deceased.	EQUITY NO. 2048 ORDER GRANTING PETITION WITH RESPECT TO KAMEHAMEHA ACTIVITIES ASSOCIATION AND THE KE ALI'I PAUAHI SCHOLARSHIP FUND (FILED OCTOBER 20, 1998) UPON CERTAIN TERMS AND CONDITIONS Date: April 23, 1999 Time: 10:00 a.m. Judge: Kevin S. C. Chang

ORDER GRANTING PETITION
WITH RESPECT TO KAMEHAMEHA ACTIVITIES ASSOCIATION
AND THE KE ALI'I PAUAHI SCHOLARSHIP FUND
(FILED OCTOBER 20, 1998)
UPON CERTAIN TERMS AND CONDITIONS

This matter came on regularly for hearing on Friday, April 23, 1999, at 10:00 a.m. before the Honorable Kevin S. C. Chang in his courtroom in Ka'ahumanu Hale, Honolulu, Hawai'i. Deputies Attorney General Dorothy Sellers and Kevin T. Wakayama appeared for Margery S. Bronster, Attorney General, State of Hawaii, as *parens patriae*. Robert Bruce Graham, Jr., appeared for Petitioners, the Trustees Under the Will and of

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

Clerk, Circuit Court, First Circuit
State of Hawaii

the Estate of Bernice Pauahi Bishop, Deceased (the "Petitioners" or the "Trustees"). Also appearing was the Special Master, Benjamin M. Matsubara.

The Court has read and considered 1) the Trustees' Petition With Respect To Kamehameha Activities Association And The Ke Ali'i Pauahi Scholarship Fund filed herein on October 20, 1998 (the "Petition"); 2) the Attorney General's Response To Petition With Respect To Kamehameha Activities Association And The Ke Ali'i Pauahi Scholarship Fund filed herein on November 19, 1998; 3) the Trustees' Response To Attorney General's Response To Petition With Respect To Kamehameha Activities Association And The Ke Ali'i Scholarship Fund filed herein on December 15, 1998; 4) the Special Master's Report Re: Petition With Respect To Kamehameha Activities Association And The Ke Ali'i Pauahi Scholarship Fund filed herein on April 12, 1999 (the "Report"); 5) the Trustees' Response To Master's Report Concerning KAA And Ke Ali'i Pauahi Scholarship Fund filed herein on April 20, 1999; 6) the Attorney General's Response To Special Master's Report Re: Kamehameha Activities Association filed herein on April 20, 1999; and 7) the records and files herein. All parties had an opportunity to be heard.

At hearing, the Special Master stated that, having reviewed and considered the April 20, 1999 Responses of the Attorney General and the Trustees to his Report, he affirmed the recommendations set forth in his Report and supplemented them with additional recommendations. The Special Master's additional recommendations were that within a time period specified by the Court, the articles, bylaws and other governing documents of the Kamehameha Activities Association ("KAA") be reviewed and amended so as to ensure (1) that all of the provisions respectively contained therein shall be in conformity with the Will of Bernice Pauahi Bishop (the "Will") and the codicils thereto, and the laws applicable thereto, and (2) that KAA shall be subject to the same rules, regulations and policies governing the Kamehameha Schools Bernice Pauahi Bishop Estate ("KSBE"); that any conflict between the provisions of KAA's corporate documents and the rules, regulations and policies of KSBE be resolved in favor of such rules, regulations and policies of KSBE; and that these amendments be subject to review by the Attorney General as *parens patriae* and approval by this Court.

The Trustees and the Attorney General accepted the Special Master's additional recommendations.

The Court accepts and approves the Special Master's Report and the Special Master's additional recommendations.

NOW THEREFORE, good cause appearing and the Court being fully advised in the premises, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the <u>Petition With Respect To Kamehameha Activities Association And The Ke Ali'i Scholarship Fund</u> filed herein on October 20, 1998 be and is hereby GRANTED, subject to the following terms and conditions:

A. The Articles, Bylaws and other governing documents of KAA and of Ke Ali'i Pauahi Scholarship Fund ("Ke Ali'i") shall be amended to provide as follows:

1. The five Trustees of KSBE shall be the sole and exclusive directors and members of KAA and Ke Ali'i, and their tenure shall be coextensive with their tenure as Trustees of KSBE, and KAA and Ke Ali'i shall not appoint any substitute or additional directors or members;

2. As directors and members of KAA and Ke Ali'i, the five Trustees shall be appointed and shall act solely in their capacities as Trustees of KSBE and not in their individual capacities;

3. In their administration and control of KAA and of Ke Ali'i, the Trustees shall be governed by all provisions of (a) the Will and the two codicils thereto, (b) all principles of trust law applicable to the Trust Estate and its Trustees, (c) all provisions of the Hawaii Revised Statutes applicable to the Trust Estate and its Trustees, (d) all court orders applicable to the Trust Estate and its Trustees, (e) all prior stipulations and agreements of the parties applicable to the Trust Estate and its Trustees, and (f) the jurisdiction of the First Circuit Court of the State of Hawaii;

4. The assets of KAA and of Ke Ali'i shall not be deemed or construed as being outside of the Trust Estate, nor the income or proceeds thereof, outside of or beyond the control of the Trust Estate, jurisdiction of the Court, or inquiry by the Attorney General as *parens patriae*;

5. The Court shall have continuing jurisdiction of KAA and of Ke Ali'i and their assets in the same manner and to the same extent as its continuing jurisdiction of the Trust Estate and its assets;

6. The special purpose financial statements and supplemental schedules described in those certain Stipulations Concerning Master's Recommendations (109th, 110th, and 111th Annual Accounts) and Order, filed herein on October 2, 1998 (the "1998 Stipulations"), and required to

be filed by the Trustees in connection with their annual reports to the Court, shall include KAA and Ke Ali'i in the consolidated reporting;

7. The Trustees' annual reports shall include a report on the status and administration of KAA and of Ke Ali'i, setting forth their valuations with the same detail and information as would be required if the same assets were held in the name of KSBE itself;

8. The court-appointed masters as to each of the Trustees' annual reports and the Attorney General as *parens patriae* shall be entitled to receive and review information concerning KAA and Ke Ali'i to the same extent and in the same manner as information concerning KSBE generally;

9. No part of the assets, funds, income or proceeds of KAA or Ke Ali'i shall inure to the benefit of any director or member of KAA or Ke Ali'i nor to any individual having a private interest in the activities of KAA or Ke Ali'i nor be used as a basis for any compensation or benefit to any director or member;

10. KAA and Ke Ali'i shall be subject to the same rules, regulations and policies governing KSBE and any conflict between the provisions of KAA's or Ke Ali'i's corporate documents and the rules, regulations and policies of KSBE shall be resolved in favor of such rules, regulations and policies of KSBE; and

11. All of the provisions contained in the Articles, Bylaws and similar governing documents of KAA and Ke Ali'i shall be in conformity with the Will and the codicils thereto, the laws applicable thereto, and the rules and

regulations of KSBE. If they are not presently in such conformity, they shall be amended as set forth in Paragraph B below.

12. The Articles, Bylaws and similar governing documents of KAA and Ke Ali'i shall not be further amended, revised or restated except upon prior notice to the Attorney General as *parens patriae* and upon prior order of the Court either obtained by stipulation or after hearing with due notice to the Attorney General as *parens patriae.*

B. All necessary amendments to conform the articles, bylaws and other governing documents of KAA and Ke Ali'i to the Will, codicils, applicable laws, rules and regulations of KSBE shall be prepared by the Trustees, shall be subject to review by the Attorney General as *parens patriae*, and shall be submitted to this Court for its review and approval. The Trustees shall formulate and submit to this Court and the Attorney General proposed amendments implementing the foregoing requirements within forty-five days of the entry of this Order Granting Petition.

C. The master(s) appointed by the Court to review the Trustees' 112th, 113th, and 114th Annual Accounts of KSBE shall review KAA and Ke Ali'i and shall report to the Court, the Trustees and the Attorney General as *parens patriae* with respect to the status, administration, implementation and circumstances of KAA and Ke Ali'i.

D. On or before December 31, 1999, the Trustees shall develop and file with this Court and serve upon the Attorney General as *parens patriae* a plan, method or methods to address the issues raised by Article XI of the Restated Articles of

Incorporation of KAA (Exhibit D to the Report) and to insure that the assets of KAA and Ke Ali'i remain within KSBE and for the exclusive benefit of KSBE in the event that either of such organizations ever ceases to exist and KSBE loses its tax-exempt status. The Trustees may include such plan or method(s) as a part of the strategic planning process and strategic plan contemplated by the 1998 Stipulations and the Stipulation Concerning Master's Recommendations (109th Annual Account); Order filed herein on December 19, 1997.

E. The Trustees shall advise the Attorney General as *parens patriae* and this Court of the result of the IRC § 509(a)(3) application filed with the Internal Revenue Service with respect to Ke Ali`i.

F. This Court expressly retains continuing jurisdiction over the Reorganization referred to in the Petition.

DATED: Honolulu, Hawaii, ~~June~~ JUL 6 1999, 1999.

/S/ KEVIN S.C. CHANG (SEAL)
Judge of the above entitled Court

APPROVED AS TO FORM:

DOROTHY SELLERS
Deputy Attorney General

BENJAMIN M. MATSUBARA
Special Master

ROBERT BRUCE GRAHAM, JR.
Attorney for Petitioners

4

ROBERT BRUCE GRAHAM, JR. 1305-0
ASHFORD & WRISTON
Alii Place, Suite 1400
1099 Alakea Street
Honolulu, Hawaii 96813
Telephone No. 539-0400

Attorney for Petitioners,
Robert Kalani Uichi Kihune,
David Paul Coon, Francis Ahloy Keala,
Constance Hee Lau and
Ronald Dale Libkuman,
Trustees under the Will and of the Estate of
Bernice Pauahi Bishop, Deceased

FIRST CIRCUIT COURT
STATE OF HAWAII
FILED

1999 AUG -6 AM 10: 46

G. HA
CLERK

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

In the Matter of the Estate Of BERNICE P. BISHOP, Deceased.	EQUITY NO. 2048 **PETITION FOR THE ESTABLISHMENT OF A PROCEDURE FOR SELECTION OF FUTURE TRUSTEES; EXHIBIT "A"**

PETITION FOR THE ESTABLISHMENT OF A PROCEDURE FOR SELECTION OF FUTURE TRUSTEES

Come now ROBERT KALANI UICHI KIHUNE, DAVID PAUL COON, FRANCIS AHLOY KEALA, CONSTANCE HEE LAU and RONALD DALE LIBKUMAN, the duly appointed, qualified and acting Interim Trustees under the Will and of the Estate of Bernice Pauahi Bishop, Deceased, acting in their fiduciary and not in their individual capacities, Petitioners herein, and respectfully petition this Court to establish a procedure for the selection of persons to serve as future trustees of the Estate of Bernice Pauahi Bishop, Deceased.

A. PROBATE RULE 126(c) STATEMENTS

1. Petitioners are the duly appointed, qualified and acting Trustees under the Will and of the Estate of Bernice Pauahi Bishop, Deceased, who died at Honolulu, Hawaii, on October 16, 1884, and whose Will and two codicils thereto were duly admitted to Probate in the Supreme Court of the Hawaiian Islands on December 2, 1884.

2. By the terms of her Will, namely Article *Thirteenth* thereof, Bernice Pauahi Bishop gave, devised and bequeathed all the rest, residue and remainder of her estate, subject to certain life interests which have lapsed or been surrendered, unto certain trustees, 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.*

A true and accurate copy of said Will is on file herein.

3. The assets of the Trust Estate consist of real, personal and other properties having an estimated value in excess of Six Billion Dollars.

4. Petitioners' post office address is Kamehameha Schools Bernice Pauahi Bishop Estate, P.O. Box 3466, Honolulu, Hawaii 96801; Petitioners' business address is Kawaiaha'o Plaza, Suite 200, 567 South King Street, Honolulu, Hawaii 96813.

5. Petitioners **DAVID PAUL COON** and **ROBERT KALANI UICHI KIHUNE** are residents of the Island and County of Hawaii, State of Hawaii, and Petitioners **FRANCIS AHLOY KEALA, RONALD DALE LIBKUMAN** and **CONSTANCE HEE LAU** are residents of the City and County of Honolulu, State of Hawaii.

6. The Trust Estate is a perpetual, charitable trust estate of which there is no vested remainder beneficiary; the Trust Estate exists solely for the benefit of The Kamehameha

Schools; there are no unborn, unascertained or minor beneficiaries of the Trust Estate; and there are no persons interested in the Trust Estate within the meaning of Section 560:7-201 of the Hawai'i Uniform Probate Code or Rule 25 of the Hawaii Probate Court Rules other than the Attorney General of the State of Hawaii, acting as *parens patriae*, who will be given notice of this Petition.

7. The Court has jurisdiction of this Petition pursuant to Hawaii Revised Statutes Sections 560:7-201(a)(1) and 603-21.7(a)(3). This Petition is filed pursuant to Hawaii Probate Rules 3 and 126 (a) and (c).

B. **DISCUSSION**

1. Article *Fourteenth* of the Will of Bernice Pauahi Bishop, provides in part as follows:

> *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, the selection to be made from persons of the Protestant religion.*

2. In Estate of Bishop, 23 Haw. 575 (1917), the Hawaii Supreme Court held that the power of appointment is vested by the Will in the Justices in their individual capacities and not in their collective or official capacity as a Court.

3. Four of the five incumbent Justices of the Hawaii Supreme Court have declared that they will no longer make appointments to KSBE's board of trustees. Attached hereto as Exhibit "A" is a true and accurate copy of the Letter From The Justices Of The Supreme Court Of Hawai'i, filed herein on April 21, 1999.

4. Because the Justices' power of appointment is personal to them and is not an official act of the Court, they cannot be compelled to exercise the power if they decline to do so.

5. Additionally, because the power of appointment is personal to the five Justices and is not an act of the Supreme Court as a court, it cannot be referred by the Supreme Court to another court or panel of justices.

6. By reason of the personal decision of four of the five Justices to decline to exercise the power of appointment, the direction of the Will that vacancies on the board of trustees "*shall be filled by the choice of a majority of the Justices of the Supreme Court*" is ineffective.

7. By that certain Order Granting Petition For Removal of Trustee Marion Mae Lokelani Lindsey Filed On December 29, 1997 entered herein on May 6, 1999, the Court (Weil, J.) granted the Petition for Removal of Trustee Lindsey filed by Trustees Oswald Kofoad Stender and Gerard Aulama Jervis. On June 10, 1999, the Court (Weil, J.) entered its Findings Of Fact And Conclusions Of Law; Order Reaffirming May 6, 1999 Order Granting Petition For Removal Of Trustee Marion Mae Lokelani Lindsey Filed On December 29, 1997. Final Judgment was entered on June 17, 1999. Ms. Lindsey has appealed the orders decreeing her permanent removal but has not obtained a stay of them.

8. By that certain Order Regarding Order To Show Cause Regarding Special Purpose Trustees' Report And Order To Show Cause Regarding New CEO Based Management System entered herein on May 7, 1999, this Court (Chang, J.) removed Trustees Wong, Peters, Lindsey and Jervis from the board of trustees on an interim basis, and accepted the

interim resignation of Trustee Stender. By that same Order, this Court appointed Petitioners to act as Interim Trustees, to serve as such pending further order of the Court.

9. Although there are no existing vacancies on the board of trustees, Petitioners serve at the pleasure of the Court. Petitioners' appointments were intended to be interim in nature and vacancies on the board of trustees will arise in the future. It is in the best interest of the Trust Estate that a procedure for making future selections of trustees be established while there is a full board of trustees in office.

10. It is axiomatic that a trust will not be allowed to fail for want of a trustee and that the Court has inherent power to fill a vacancy on the board of a trust. It is vitally important that there be a definite procedure whereby future vacancies arising on KSBE's board of trustees may be filled in a manner as nearly consistent with the Will of Bernice Pauahi Bishop as possible.

11. The procedure employed should also be designed to ensure that the persons selected to serve as trustees (i) are qualified to serve as fiduciaries of an educational trust; (ii) understand the role and duties of trustees generally and are familiar with the specific terms and conditions of the Will; (iii) are able to serve without conflict of interest; and (iv) are sensitive to the unique role of the Kamehameha Schools Bernice Pauahi Bishop Estate in the Hawaiian and statewide communities.

12. Petitioners have identified the elements of a future selection process that Petitioners deem essential to the needs of the Trust Estate and to the perception of integrity and fairness. These are set forth below. Petitioners offer their observations and comments based upon their own insights and upon discussions with members of the Kamehameha ohana and

others in the community. Petitioners offer these observations and comments not by way of petition for their approval as written but as a submission to this Court for its consideration and review in connection with the establishment of a procedure for the selection of future trustees.

13. Petitioners urge the Court to establish a means by which persons other than Petitioners also may submit their observations and suggestions to the Court.

14. Petitioners respectfully submit that, pursuant to Rule 28(a) of the Hawaii Probate Rules, the Court should appoint a master to review this petition, and to receive, review and comment upon observations and suggestions offered the Court, including but not limited to the observations and suggestions of Petitioners set forth hereinbelow.

C. PETITIONERS' OBSERVATIONS AND COMMENTS

1. Appointment of a Selection Committee

a. A Trustee Selection Committee ("Committee") should be appointed by the Court. The purpose of the Committee should be to:

- Announce an existing or expected vacancy to the public;
- Receive applications and nominations for the vacant position;
- Solicit qualified candidates who may not have applied or been nominated;
- Review the applications according to an established set of criteria;
- Provide for written public comment; and
- Submit a list of recommended candidates to the Court.

b. The Committee should be comprised of persons representative of the Kamehameha ohana, including alumni, teachers and families of students, and of the Hawaiian community and the community at large. Members of the Committee should possess experience and insight into the operation and management of large private educational institutions, large financial institutions, or large charitable trusts or foundations. As a whole, the Committee should have a broad experience upon which to make its nominations to the Court.

c. The members of the Committee should appoint a chairperson from among them. The members should serve without compensation. Payment of the Committee's reasonable expenses should be made out of the Trust Estate upon approval by the Court.

2. <u>Selection Process</u>

a. When a vacancy occurs or is expected to occur, the then-incumbent trustees should submit a petition to the Court requesting that a Committee be empanelled by the Court. If it is shown that there is or will be a vacancy, the Court should constitute the Committee, selecting its members based upon the considerations set forth above.

b. The Committee should have the authority to retain a consultant knowledgeable and experienced in the hiring of executive personnel. The consultant should assist the Committee in organizing, screening, and reviewing applications and nominations for the vacant trusteeship position. The consultant should verify information provided by the applicant, including the applicant's educational background, background in business, honors and awards, and volunteer work in the community.

c. The Committee should commence with a review of applications received. In the event of a conflict of interest between a Committee member and an applicant who has met the minimum qualifications, the member should declare that a conflict exists and fully describe the nature and extent of the conflict. The remaining members of the Committee should determine whether the member in question should withdraw from consideration of the candidate in question.

d. Based on information in the applications and gathered by the consultant, the number of persons under consideration should be reduced to six persons. The Committee then should proceed with interviews of the six persons to determine three finalists. The names of the three finalists then should be submitted to the Court in a writing filed as a public record. If there is more than one vacant position, the number of finalists should be the sum of three plus one for each additional vacancy. From this list of finalists, the Court should select the trustee(s). Ultimately, it is incumbent upon the Court to ascertain the fitness of the persons selected by it and, in the event that none of the finalists nominated by the Committee is approved by the Court, the Court should advise the Committee in writing of its reasons and request that the Committee submit an equivalent number of additional nominations. The Court should make its appointment(s) only from the nominations made by the Committee.

3. Selection Criteria

a. The optimal candidate would (i) have a history of success in business, finance or related areas; (ii) have received a formal education; (iii) possess outstanding personal traits including Hawaiian values such as *pono* (to be moral and proper), *'imi 'ike* (to seek knowledge), *laulima* (to work cooperatively), *lokomaika'i* (to share), *na'au pono* (to possess a deep sense of justice), *malama* (to care for each other), and *ha'a ha'a* (to be humble).

b. Categorically, the following criteria should be established:

(1) Experience

The candidate should possess expertise in one or more of the following areas:

- Business Administration: to include knowledge, skills, and prior successful experience in managing a large corporation;
- Finance and Investment: to include management of land and monetary assets of a multi-million dollar corporation;
- Strategic Planning and Policy Setting: to include responsibility for administering the affairs and/or setting policies for the direction and management of a large corporation or educational institution;

- General areas of interest, including education, law, finance or an especially relevant background in governance.

(2) Political Office

The candidate should not currently hold any elected political office nor have held any political office within the five years immediately preceding his or her nomination.

(3) Religious Affiliation

The Will of Bernice Pauahi Bishop provides that the selections for trustees shall be made from persons of the Protestant religion.

(4) Personal Qualities and Characteristics

The desirable qualities and characteristics of a trustee should include:

- A demonstrated reputation of integrity, the capacity to fulfill the responsibilities of a fiduciary under trust law, and a commitment to the best interests of children;
- Consistent and active leadership in the community-at-large;
- A willingness and sincerity to uphold the purposes of KSBE as stated in the Will of Bernice Pauahi Bishop.

(5) Preferences

If two candidates are perceived as equally qualified, preference should be given to the candidate who is:

- An alumnus of the Kamehameha Schools, or
- Of Hawaiian ancestry.

4. Term Limits and Retention Process

a. Each trustee should be appointed to a term of five years, after which the trustee may submit an application to the Court to serve another term of five years. The Court should refer any application for reappointment to a Committee constituted by the Court in accordance with these procedures. The Committee should either recommend reappointment of the trustee or proceed with the selection process and submit the names of three finalists to the Court, in which event the trustee applying for reappointment could be one of the three finalists submitted to the Court.

b. The trustees should be limited to a maximum of two five-year terms, whether or not consecutive. There should be no mandatory retirement age nor any other arbitrary limit upon the term of the trustees, except that where more than one trustee is selected at the same time, their respective terms should be staggered to ensure that no more than two trustee terms expire within the same year.

D. CONCLUSION

Upon the foregoing, Petitioners respectfully pray as follows:

1. That this Honorable Court make and enter its order fixing a date and time for hearing of this Petition;

2. That this Honorable Court appoint a master to review this Petition, to receive, review and comment upon observations and suggestions offered the Court, including but not limited to the observations and suggestions of Petitioners set forth herein; and report to the Court;

3. That upon hearing hereof, this Court make and enter its Order and Decree establishing a selection process for the appointment of future trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate; and

4. That this Court grant such other and further relief as to this Honorable Court shall seem just and equitable in the premises.

Each of the undersigned persons understands that this Petition is deemed to include an oath, affirmation or statement to the effect that its representations are true as far as each of the undersigned persons knows or is informed, and that penalties for perjury may follow deliberate falsification.

DATED: Honolulu, Hawaii, this 6th day of August, 1999.

ROBERT KALANI UICHI KIHUNE

DAVID PAUL COON

FRANCIS AHLOY KEALA

CONSTANCE HEE LAU

RONALD DALE LIBKUMAN

Trustees Under the Will and of the Estate of Bernice Pauahi Bishop, Deceased

Hawaii Probate Rule 5(b) Certification:

Robert Bruce Graham, Jr.
Attorney for Petitioners,
Trustees Under The Will and of
the Estate of Bernice Pauahi Bishop, Deceased

1999 APR 21 AM 8:37

G. HA
CLERK

ORIGINAL

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT

STATE OF HAWAII

In the Matter of the Estate of BERNICE P. BISHOP, Deceased.	EQUITY NO. 2048 LETTER FROM THE JUSTICES OF THE SUPREME COURT OF HAWAI'I

LETTER FROM THE JUSTICES OF THE SUPREME COURT OF HAWAI'I

On April 20, 1999, the undersigned civil administrative and probate judge received a letter dated April 19, 1999, from the justices of the Supreme Court of Hawai'i. The above-referenced letter is attached hereto as Exhibit "1", and is hereby filed in Equity No. 2048.

Dated: Honolulu, Hawaii, April 21, 1999.

JUDGE OF THE ABOVE-ENTITLED COURT

EXHIBIT "A"

35

April 19, 1999

Hon. Kevin Chang
Administrative/Probate Judge
Circuit Court of the First Circuit
777 Punchbowl Street
Honolulu, HI 96813

Re: **EQUITY NO. 2048**

Dear Judge Chang:

On December 20, 1997, four of the five justices of the Supreme Court of Hawai`i advised probate judge, the Honorable Colleen Hirai, that they would no longer be exercising the powers to appoint trustees of the Board of the Bishop Estate granted by the will of Princess Bernice Pauahi Bishop. See attachment.

The undersigned justices of the Supreme Court of Hawai`i, in our individual capacities, hereby request that the attachment and this letter be properly docketed in Equity No. 2048.

Thank you for your attention to this matter.

Sincerely,

RONALD T. Y. MOON

ROBERT G. KLEIN (dissent)

STEVEN H. LEVINSON

PAULA A. NAKAYAMA

MARIO R. RAMIL

Attch.

EXHIBIT "1"

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December 20, 1997

Hon. Colleen Hirai
Judge, Circuit Court of the First Circuit,
Probate Division
777 Punchbowl Street
Honolulu, HI 96813

RE: **Estate of Princess Bernice Pauahi Bishop**

Dear Judge Hirai:

The undersigned justices of the Supreme Court of Hawai'i, in our individual capacities, hereby give notice that we will not exercise the powers to appoint trustees to the Board of the Bishop Estate granted by the will of Princess Bernice Pauahi Bishop.

Sincerely,

RONALD T. Y. MOON

STEVEN H. LEVINSON

PAULA A. NAKAYAMA

MARIO R. RAMIL

cc: Hon. Virginia Lea Crandall
Administrative Judge
First Circuit Court

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ATTACHMENT 5

Policy Title:
<u>Board of Trustees' Duties</u>

In accordance with standards of trust law applicable to the trustees of perpetual, charitable trusts, and the Will, the Trustees collectively shall perform and fulfill the following acts and duties in view of the manner in which persons of ordinary prudence, diligence, discretion, and judgment would act in the management of their own affairs. The Trustees shall:

A. Establish the policies, goals, and objectives of KSBE consistent with the mission. The policies shall be established to ensure that the Trustees' fiduciary obligations are met. Board established policies shall include, but not be limited to, the following:

- strategic plan policy that addresses KSBE's primary educational objectives and financial objectives in support thereof.
- spending policy
- investment policy
- exempt organization policy
- inter-KSBE subsidiary transactions policy
- conflicts of interest policy
- accounting policy
- internal audit policy

B. Oversee the implementation of KSBE's policies and procedures and take all steps necessary to ensure that KSBE is being managed in a manner consistent with its mission, and that its assets are being managed prudently and only for KSBE's exclusively charitable purposes. All functions and decisions shall be measured against the mission.

C. Make substantive strategic policies affecting the administration of KSBE such as its educational and financial objectives and other major plans and actions.

D. Oversee the management of KSBE's finances, including reviewing and approving annual budgets, periodically reviewing financial projections, and establishing and implementing fiscal controls sufficient to assure that KSBE's resources are expended only for KSBE's purposes. The Board collectively and each Trustee individually is accountable for the financial well-being of KSBE.

E. Select, regularly evaluate, fix the compensation of, and where appropriate, hire or replace the CEO of KSBE. The specific organization of Principal Executives is a matter that will be addressed by the CEO for approval, as applicable, to the Board, subject to applicable provisions of law. Principal Executives shall currently consist of persons serving in the capacities of a Chief Executive Officer (CEO), the President of the Schools, and a Chief Operating Officer (COO). See Appendix A for KSBE organizational chart. The titles and numbers of the Principal Executive positions may vary but their roles and responsibilities shall be consistent with standards of delegation of authority and responsibility incumbent upon the Board as the prudent fiduciaries of an institution requiring a diversity of demonstrated professional and managerial expertise that the Trustees themselves are not expected to exercise. In so delegating, the Trustees must exercise reasonable care, skill, and caution in selecting the CEO; establishing the scope and terms of CEO's duties; and periodically reviewing CEO's actions in order to monitor his/her performance and compliance with Board directives.

F. Set limits on the means with which the CEO and KSBE staff operate by establishing principles of prudence and ethics, forming the parameters for all management and staff practices, activities, circumstances, and methods.

G. Monitor Board directives to the CEO and professional consultants retained by the Board to ensure implementation in accordance with such directives.

H. Hold the CEO accountable for ensuring compliance with applicable federal and state laws and regulations and court orders regarding the administration of the Trust, and for minimizing exposure to legal action.

I. Preserve the tax-exempt status of the Trust Estate by ensuring that the CEO at all times is cognizant of and demonstrates continuing sensitivity to the requirements that the conduct of KSBE's tax-exempt entities and organizations must always be consistent with their IRC 501(c)(3) status and that all activities of all taxable subsidiaries and affiliates of KSBE must not jeopardize the tax-exempt status of the exempt entities.

J. Represent the persons intended to benefit from the purposes expressed in the Will of KSBE in determining and demanding appropriate organizational performance. To distinguish the Board's own unique job from the jobs of its staff, the Board will concentrate its efforts on written governing policies which, at the broadest levels, address:

   1. Governance Process: Specification of how the Board conceives, carries out and monitors its own task.

   2. Executive Boundaries: Constraints on executive authority which establish the prudence and ethical boundaries within which all executive activity and decisions must take place.

   3. Board-CEO Relationship: How responsibilities are delegated and its proper use monitored; the Chief Executive Officer's role, authority and accountability.

4. Ends: Organizational products, impacts, benefits, outcomes, recipients, and their relative worth.

5. Internal Audit: Guidance for independent appraisal and examination of all control functions within KSBE, including functions of the Board of Trustees.

K. In accordance with the Will, the Trustees will provide relevant information concerning the governance and administration of KSBE in a timely manner to the Attorney General as parens patriae.

L. The Trustees will not have day-to-day responsibility for the management of KSBE.

Policy Title:
<u>Chairperson's Role</u>

The Chairperson will be selected by the Board of Trustees by majority vote. The Chairperson's primary role is the integrity of the Board's process and, secondarily, occasional representation of the Board to outside parties. The Chairperson is generally the Trustee authorized to speak for the Board (beyond simply reporting Board decisions).

The job of the Chairperson is to ensure the Board behaves consistently with its own policies and rules.

1. Board discussions will only be those issues which, according to Board policy, clearly belong to the Board to decide. The CEO will develop the agenda for each Board meeting.

2. Deliberation will be fair, open, and thorough, but also efficient, timely, orderly and kept to the point.

3. The Board will offer the opportunity for input from individual employees or staff groups, including subsidiaries and affiliated organizations, which have expertise and interests specifically related to Board decisions and Board policies.

4. The authority of the Chairperson consists of making decisions that fall within the topics covered by Board policies on Governance Process and Board-CEO Relationship, except where the Board specifically delegates portions of this authority to others. The Chairperson is authorized to use any reasonable interpretation of the provisions in these policies.

5. The Chairperson is empowered to chair Board meetings with the commonly accepted power of that position (e.g., ruling, recognizing).

6. The Chairperson, being an individual Trustee, has no authority to make decisions about policies. The Chairperson may meet individually with the CEO to discuss progress or issues of interest to the Board. The CEO will keep other Trustees informed of significant issues discussed during these meetings.

7. The Chairperson may represent the Board to outside parties in announcing Board-stated positions and in stating Chair decisions and interpretations within the area delegated to him or her.

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PROCEDURE FOR REMOVAL OR SUSPENSION OF TRUSTEE(S)

Pursuant to the inherent power of the courts of equity and the authority codified in Hawaii Revised Statutes Section 560:7-201, the Circuit Courts of the State of Hawaii have power to remove for cause a trustee of a charitable trust, including a trustee of the Kamehameha Schools Bernice Pauahi Bishop Estate. As stated by the Supreme Court of Hawaii:

> A court of equity may and will remove a trustee who has been guilty of some breach of trust or violation of duty. The exercise of this function by a court of equity belongs to what is called its sound judicial discretion and is not controlled by positive rules except that the discretion must not be abused.

In re Estate of Holt, 33 Haw. 352, 357 (1935).

A petition for removal of a trustee may be commenced by another trustee, the court-appointed master, or the Attorney General of the State of Hawaii, as *parens patriae*. *See* Richards v. Midkiff, 48 Haw. 32, 42-43 (1964); Hawaii Revised Statutes Section 560:7:101.

Pursuant to Recommendation No. 13 of the *Stipulation Concerning Master's Recommendations (109th Annual Account); Order* entered on December 19, 1997, in Estate of Bernice P. Bishop, Deceased, Equity No. 2048, First Circuit, State of Hawaii, the Trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate have acknowledged that where any of them is aware of a potential breach of trust by any other Trustee, there is an affirmative duty to act to protect the Trust Estate. In instances where *bona fide* issues are raised regarding a breach of trust by one or more Trustees, it is incumbent upon the other Trustees to investigate the facts and circumstances, to identify applicable legal standards that may have been violated, to determine if the Trust Estate has been injured or prejudiced by the acts or omissions, and to take appropriate steps to seek redress for the Trust Estate. In appropriate circumstances, such action includes initiating or cooperating in proceedings for the removal of the offending Trustee.

Removal is warranted if the Court concludes that allowing a Trustee to continue in office would be detrimental to the interests of the trust estate. Restatement (Second) Trusts § 107, comment a (1959). Grounds for removal of a Trustee include, but are not limited to, the following:

1. Incapacity (usually due to sickness or mental infirmity);
2. Unfitness;
3. Extreme personal improvidence, insolvency, or bankruptcy;
4. Commission of a serious crime, especially one involving dishonesty;
5. Misconduct evidencing moral turpitude or abuse of office;
6. Knowing failure to obey a court order;
7. Knowing failure to comply with law and regulation applicable to the trust estate;
8. Knowing failure to render complete and accurate accounts;
9. Knowing misrepresentation of the affairs of the trust estate;
10. Disobedience to the directions and terms of the trust instrument;
11. Failure to act appropriately in the affairs of the trust;
12. Activity detrimental to the obvious best interest of the trust;
13. Neglect of the office of trustee;
14. Unreasonable or corrupt failure to cooperate with co-trustees;

15. Failure to respond in a timely and reasonable manner to reasonable requests of the court appointed master or the Attorney General as *parens patriae* for information concerning the affairs of the trust estate.
16. Mismanagement of the trust estate;
17. Commingling trust and personal funds;
18. Acquiring a personal interest adverse to the trust;
19. Self-dealing;
20. Permitting or accepting any degree of private inurement;
21. Failure to disclose known conflicts of interest;
22. Failure to abstain from any involvement in transactions in which the trustee has a conflict of interest;
23. Appropriation of trust property to personal use;
24. Making unauthorized dispositions of trust property;
25. Waste of trust assets;
26. Activities which jeopardize the tax exempt status of the trust estate;
27. Activities which expose the trust estate or its subsidiaries to significant civil or criminal penalties and forfeitures; and
28. Willful and wanton abuse of discretion.

The foregoing list of grounds is not exhaustive. In all cases the burden of proof is upon those seeking removal of a Trustee and the determination lies with the Court. Nonetheless, a Trustee whose removal is sought has a fiduciary duty to assess the allegations against him and, if it is clear that they are substantially accurate and the Trustee's continued service would be detrimental to the trust estate, whether monetarily or otherwise, the Trustee should tender his resignation to the Court. The Trustee thereafter is entitled to defend himself and to seek discharge from any liability to the trust estate but, in removal proceedings as in all other trust affairs, should place the welfare of the trust estate ahead of personal vindication.

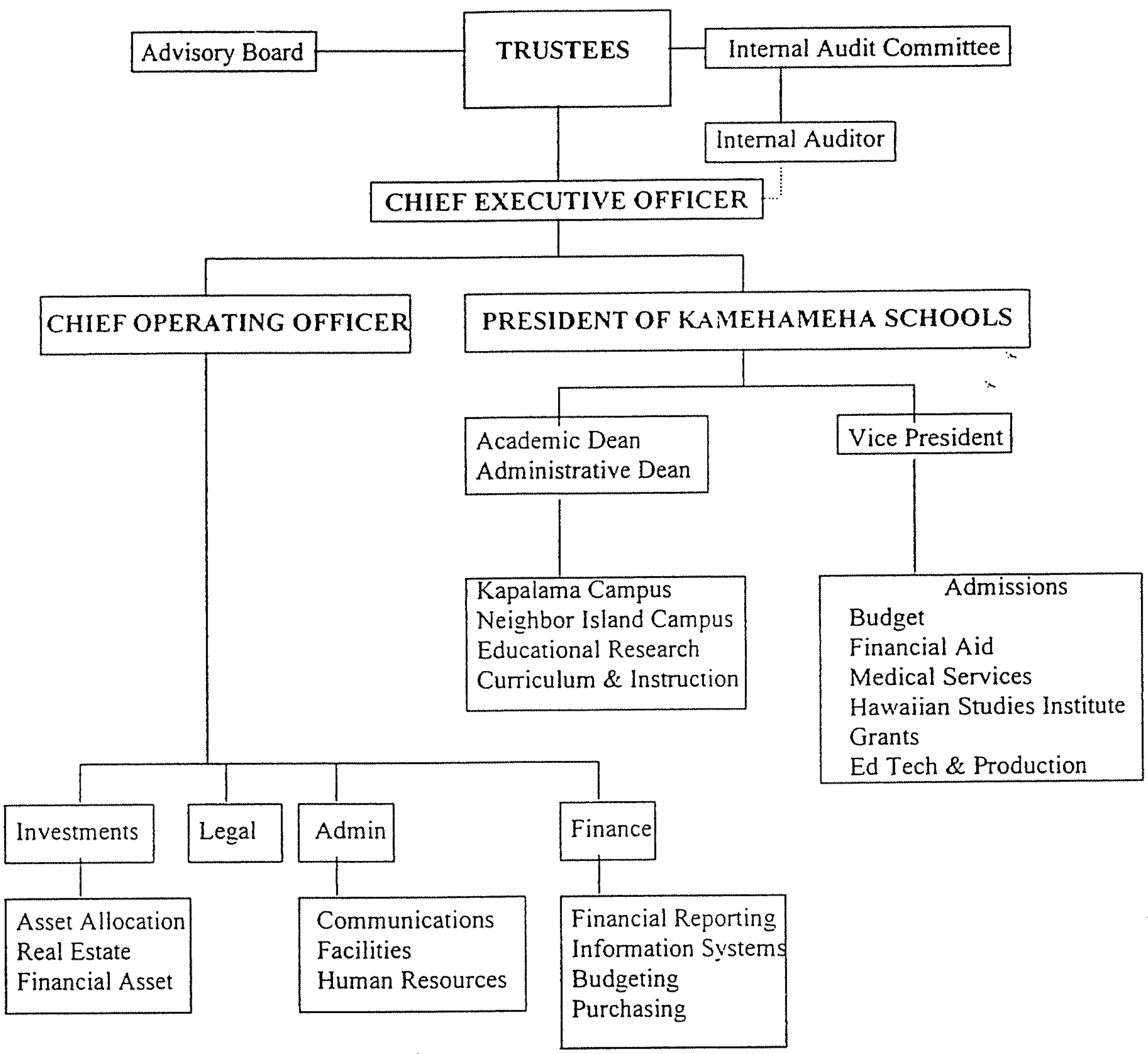
A trustee who acts maliciously, recklessly or in knowing disregard of the facts in seeking removal of a co-trustee is himself liable for removal.

In all things, Trustees must be guided by the often-quoted words of Chief Justice Cardozo:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546, 62 A.L.R. 1 (1928).

ATTACHMENT 7



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ATTACHMENT 8

POSITION SPECIFICATION

Position Chief Executive Officer

Location Honolulu, Hawaii

Organization Kamehameha Schools Bernice Pauahi Bishop Estate

Kamehameha Schools Bernice Pauahi Bishop Estate (KSBE or Kamehameha Schools Bishop Estate) was created in 1884 pursuant to the Last Will and Testament of Bernice Pauahi Bishop (The Will), the last direct descendant of Hawaii's royal Kamehameha line. KSBE's exclusive purpose, in accordance with The Will, is to provide educational opportunities to children of native Hawaiian ancestry in perpetuity. To fulfill this purpose, KSBE is a charitable trust which operates and maintains a large K-12 private school on Kapalama Heights in Honolulu, as well as satellite schools and outreach educational programs throughout the islands. In accordance with The Will, the income from the estate of Bernice Pauahi Bishop, which originally comprised mainly of real estate holdings, would be used to build and support the Kamehameha Schools and other educational programs. Today, KSBE, while still maintaining its exclusive purpose of education, is a large, diversified organization. The schools and educational programs continue to expand. To support this expanding educational requirement, opportunities for revenues have been diversified to include investments in Hawaii, the mainland, and in other countries.

The Kamehameha Schools educate over 3,800 students per year from preschool through high school at various campus sites in Hawaii. The main campus at Kapalama Heights in Honolulu graduates approximately 450 high school students each year. Post-high financial aid scholarships aggregating over $15 million are awarded each year to approximately 3,000 students attending university and colleges. The budget for the overall Kamehameha Schools system exceeds $120 million annually.

To support the operation and maintenance of the schools, KSBE's assets have generated yearly revenues in excess of $120 million. Some of these assets include:

- 173,000 acres of conservation land
- 189,000 acres of agricultural land
- 833 acres of commercial property which generate approximately 85% of KSBE'S annual revenue
- Investment portfolio which includes liquid assets such as paper securities

Organizational governance is provided by five Trustees who are individually and collectively responsible for the governance of KSBE, but not its day to day management. In 1998, the Trustees revised the organization's management to provide for a Chief

Executive Officer (CEO) to serve under and report to the Board of Trustees. The CEO would direct, administer and coordinate KSBE's activities, its subsidiary corporations, partnerships, affiliates and investments in accordance with the scope and terms of such delegations of authority as may from time to time be made to the CEO by the Trustees pursuant to the provisions of applicable law, including without limitation Chap. 554A and §554C-9 of the Hawaii Revised Statues.

KSBE will be undergoing a strategic planning process in mid to late calendar year 1999. Consequently, the current KSBE organizational structure may be subject to change depending upon the recommendations of the strategic planning process. The CEO will be a key participant in this strategic planning. The current organizational structure approved by the Board of Trustees is attached.

Reporting Relationships

The CEO will report directly to the Chairperson of the Board of Trustees, serving as a communications conduit between the Board of Trustees and the KSBE management staff.

The President of Kamehameha Schools and the Chief Operating Officer will report directly to the CEO.

The President of the Schools is delegated the authority for all personnel decisions and actions relating to both faculty and schools' staff personnel.

Position Summary

In performing each function delegated to the CEO by the Trustees, the CEO owes a duty to the Trust to exercise reasonable care and skill to comply with the terms of the delegation. The CEO acts as a spokesperson for the organization and is directly responsible and accountable to the Board of Trustees for the operation of KSBE within the scope and terms of such delegated authority by the Board of Trustees. The CEO is accountable to the Board of Trustees for the planning, coordination, development and execution of plans to fulfill the vision and mission of KSBE and is responsible for assuring that goals and targets established from time to time by the Board of Trustees and communicated to the CEO are met and, if they are not, that necessary adjustments and corrections are made. The CEO's general activities are outlined below. It is emphasized, however, that the representations below are of a general nature and may include other activities and responsibilities as may be directed or delegated from time to time by the Board of Trustees.

Primary Responsibilities

Ensure that KSBE is operated in a manner that is consistent with its tax exempt status.

Plan, coordinate and direct the implementation of the Board of Trustees' educational goals and objectives.

Plan, coordinate and direct the implementation of the Board of Trustees' goals and objectives in the deployment of Estate assets and the overall management of Estate investment activities and properties.

Review budgets, plans and objectives and make recommendations to the Board of Trustees for the adoption or modification of policies to more effectively and efficiently implement these budgets, plans and objectives.

Determine and prescribe the tasks of, and the specific limitations on, the authority of the CEO's subordinates, including but not limited to tasks and limitations regarding (a) development of plans, goals and objectives within each department or division, (b) participation in the development of overall plans for KSBE, (c) making contractual commitments, (d) authorizing expenditures, (e) executing "routine legal documents" on KSBE's behalf, and (f) supervising, retaining, disciplining, transferring and terminating personnel, except those personnel who are assigned to the schools.

Review and recommend to the Board of Trustees the appointment, employment, disciplining, transfer or termination of the Principal Executives (The President of the Schools and the Chief Operating Officer). All other personnel decisions and actions are delegated by the Board of Trustees to the CEO and the President of the Schools, as explained earlier.

Keep the Board of Trustees fully and currently informed concerning the condition of KSBE and its constituent elements and all important factors assessed to have an affect upon KSBE policies and operations.

Develop a strategic plan, along with the Kamehameha Schools Strategic Education and Operations Plan and the Strategic Spending Plan that are designed to fulfill KSBE's educational mission and goals, including plans and programs for the development, enhancement and deployment of KSBE's assets to financially support KSBE's long range educational mission and goals. Establish performance analysis systems to measure the outcomes of the strategic plan and make tactical changes to meet changing conditions.

Assume responsibility for and provide overall management of all KSBE operations, including the development and execution of fiscal controls; the acquisition of new assets; the use, development, management and diversification of new and existing assets and activities, actually or potentially, affecting the value of KSBE assets, such as land use activities. Act as necessary to correct situations where programs and operations fall short of goals.

To the greatest extent reasonably achievable, develop and implement measurements of effectiveness that determine if KSBE is maximizing the prudent use and investment of its resources to fulfill its educational mission.

Meet with governmental executives and administrative and legislative representatives, attending community association meetings, public hearings and information meetings to coordinate and promote KSBE's goals and objectives.

Build and develop strong alliances with educational and business associates and affiliates.

Insure services being provided by consultants and contractors are essential to the mission and goals of KSBE and all transactions are being conducted under the highest standards of business ethics.

Develop and maintain ethically sound working relationships between staff members and partners, associates, subsidiaries and affiliates, lessees and tenants, consultants, community groups, and governmental agencies and commissions.

Guide and direct the Principal Executives (The President of the Schools and Chief Operating Officer), as necessary.

Develop and maintain a sound plan of organization. Provide plans for any major organizational change to the Board of Trustees for review and approval.

Motivate, develop and strengthen KSBE's management team with talent and technology, within approved budgetary limits, to ensure that sufficient depth of management is available to meet KSBE's present and foreseeable needs. Establish procedures to insure adequate management development and provision for capable management succession.

Direct, develop and implement procedures and controls to maintain adequate communications within and among the KSBE staff.

Develop the agenda and oversee the preparation of minutes for the regular meetings of the Board of Trustees. Brief the Board of Trustees on all matters which require their consideration and approval.

Oversee the development and establishment of adequate and equitable personnel policies, salary administration policies, incentive plans, and employee benefit plans.

Insure that all activities and operations are carried out in compliance with such directives as the Board of Trustees may give the CEO and within all applicable governmental laws, rules and regulations governing KSBE operations.

Respond to all inquires made by the Board of Trustees and, depending upon the level or severity of the inquiries, to outside agencies and organizations.

Coordinate the preparation of reports to the First Circuit Court, income forecasts, tax reports and returns, operating budgets and reports to the Trustees.

Participate in public and civic activities to enhance KSBE's image and public relations.

Maintain a zero tolerance drug free environment within KSBE.

Create and maintain a positive working environment within KSBE that does not discriminate against any employee or student because of gender, race, cultural background, or religious beliefs. Maintain a zero tolerance environment against sexual harassment or any other unlawful abuses against students and employees.

Substitute for Principal Executives (The President of the Schools or the Chief Operating Officer) in their absence as necessary.

Assume such other duties and responsibilities as may from time to time be conferred upon the CEO by the Board of Trustees.

Authority Delegated

The authority delegated by the Board of Trustees to the CEO encompasses all such authority as is reasonably required to accomplish the tasks herein above required by the CEO.

Ideal Experience

To the greatest extent possible, the ideal candidate should have the following background and experience:

- Broad management experience at or near the top management of a large education institution, trust or business organization of comparable total asset worth.

- A caring and proven leader and manager who has handled complex operations in any of the following: large educational institution; large business; large diversified real estate and management business; or large financial institution.

- Unquestioned integrity and a positive executive image.

- Proven public speaking ability.

Qualifications

The ideal CEO will have the following minimum qualifications:

- A minimum of 15 years of general management experience, preferably as CEO, Chief Operating Officer or equivalent, in management of a large educational institution or major and diverse business organization.

- A college degree is essential, with graduate degrees such as a Master's degree, highly desirable.

Personal Characteristics

The following are the personal characteristics being sought in the successful candidate:

- A warm, confident personality, enabling the individual to lead by persuasion and example. An individual who instills basic values such as hard work, honor, integrity, family and discipline, while appreciating the need for humor and fun in the workplace.

- A consultative but positive leadership style. Exemplary communication and interpersonal skills, enabling the individual to communicate effectively with all levels of the KSBE organization, the Trustees, outside consultants, other participants in both educational and financial organizations, and with the community at large.

- An ability to listen carefully and respectfully to the opinions of others and to accept the useful contributions of subordinates, while at the same time keeping a clear sense of task objectives and goals and making sound decisions which assist in the implementation of such objectives and the achievement of such goals.

- Creative analytical and problem solving skills, which are not hampered by conventional approaches, but instead reflect an ability to think "outside of the box". The confidence to champion a contrary or "unpopular" view.

- A positive attitude, enabling the active promotion and implementation of final decisions by the Board of Trustees even where such decisions may be contrary to the individual's personal views.

- A motivated and intuitive self-starter, with a strong work ethic and the potential to add value to the organization almost immediately.

- A bright, dynamic and trustworthy individual, having the ability to gain the confidence of the entire KSBE organization almost immediately.

- A manager who is organized, pays attention to detail without getting lost in it, who works effectively under pressure and is able to continually manage apparently conflicting priorities. A multiple, rather than a serial, processor of objectives.

Compensation

Further detail to be provided regarding CEO compensation.

POSITION SPECIFICATION

Position Director, Internal Audit

Location Honolulu, Hawaii

Organization Kamehameha Schools Bernice Pauahi Bishop Estate (KSBE) and Subsidiaries

Position Summary:

The Director of Internal Audit (Director) is authorized and responsible for directing KSBE's internal audit function which primarily includes the development and execution of a Comprehensive Audit Program that serves to monitor the affairs of KSBE to ensure, among other things, the following:

- The terms of the Will of Bernice P. Bishop (the "Will") are fulfilled in perpetuity.

- Assets of the Estate are properly safeguarded from financial loss and it is used primarily for educational purposes.

- Policies and procedures by the Board of Trustees are adhered to.

- Compliance with applicable state and federal laws, regulations and agreements (including court orders, stipulations, and closing agreement with the Internal Revenue Service) is maintained.

The internal auditing function examines and evaluates the processes that provide oversight and controls in all areas of KSBE to determine whether they are effective and efficient, to identify where risk exist, and how to establish or improve processes and controls to mitigate risk to KSBE. In accomplishing these activities, the Director and members of the audit staff are authorized to have full, free and unrestricted access to all KSBE information and records, including those of the taxable subsidiaries and the Trustees.

The Director shall report directly to the Audit Committee. Administratively, the Director will report to the CEO.

Essential Job Functions:

Establishing policies for the internal audit function and directing its technical and administrative functions.

Developing and executing a Comprehensive Audit Program for the evaluation of the processes that provide oversight and controls in all areas of KSBE, including the Board of Trustees. Updating and adapting the audit program to meet the needs resulting from organizational changes.

Supervise and direct internal audit staff in the proper execution of the Comprehensive Audit Program.

Examining the effectiveness of the Board of Trustees and all levels of management in their stewardship of KSBE resources and their compliance with policies and procedures, government laws, regulations and agreements including court orders, stipulations and the closing agreement with the Internal Revenue Service.

Reviewing procedures and records for their adequacy to accomplish intended objectives.

Reporting the results of audit examinations, including recommendations for improvement.

Ensure that recommendations for improvement and correction of reported deficiencies are implemented and addressed in a timely manner.

Conducting special reviews of the request of the Audit Committee.

Attends Board of Trustees meetings, at the Director's discretion, to monitor the Trustees' oversight process and effectiveness.

Interaction with the Audit Committee, upper management and the external auditors.

Continuously evaluate and improve the overall efficiency and effectiveness of the internal audit function to ensure it achieves its stated mission.

Working Conditions:

Work is performed throughout KSBE, its subsidiaries, and related entities and requires travel to attend meetings and visit properties and investments of these entities throughout the world.

Work involves highly confidential information and, at times, may involve discussions with Trustees, management, and staff of a very sensitive nature.

Minimum Qualifications:

A bachelor's degree.

Certified Public Accountant designation. Five to six years of auditing experience including two or three years with a CPA firm.

Good understanding of general business, finance and accounting.

Good interpersonal, leadership, technical, analytical, administrative and supervisory skills.

Good oral and written communication skills.

Preferred Qualifications:

Certified Internal Auditor designation

Masters degree in Business Administration. Accounting, Finance or related field.

Auditing and/or tax experience involving an educational or charitable trust institution helpful.

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1200 CONFLICTS OF INTEREST - TRUSTEES

Principles of trust law require that the Trustees of the Estate of Bernice Pauahi Bishop (the Kamehameha Schools Bishop Estate or "KSBE") maintain the highest standards of integrity, ethics and business morals and demonstrate their undivided loyalty to the persons intended to benefit from the charitable purposes expressed in the Will of Bernice Pauahi Bishop.

To achieve this goal, each Trustee 1) avoids knowing participation in any transaction which may be an actual or potential Conflict of Interest, 2) discloses information about personal financial interests or external activities which present potential or actual Conflicts of Interest, and 3) adheres to prescribed, on-going disclosure and review procedures developed specifically to avoid actual or potential Conflicts of Interest.

In general, the Trustees may not deal with the trust property individually nor hold a position of conflicting interest with KSBE. The Trustees' duty of loyalty requires that they administer the trust solely with a view to the accomplishment of the purposes of the trust and not with a view to promoting their own interests.

Corporate and partnership opportunities, knowledge, directorships, memberships and other benefits accruing to KSBE or its Trustees by reason of KSBE's ownership of an interest in the entity, contractual rights or voting strength shall belong to and be the property of KSBE and any compensation, benefit, option or opportunity inuring to any Trustee in connection with such entities shall belong to and be the property of KSBE.

The Board of Trustees, together with KSBE General Counsel, shall review and update this policy and these procedures on a periodic basis to ensure adherence to the highest standards of integrity, ethics and business morals by each Trustee.

Responsible for Documentation and Implementation of Policy and Procedure: Trustees and General Counsel, Legal Group

Accountable for Results: Trustees

1200.2 **Procedures/Guidelines**

I. Definitions Associated With Trustee Conflicts of Interest Policy

II. Situations Which Could Lead to Trustee Conflicts of Interest

III. Guidelines to Address Trustee Conflicts of Interest

IV. Violations of the Conflicts of Interest Policy

V. Records of Proceedings

VI. Disclosure of Financial and External Activities

A. "Trustees Disclosure of Financial Interests and External Activities" Form

I

Definitions Associated With Trustee Conflicts of Interest Policy

A. **Conflicts of Interest Defined**

1. A Conflict of Interest is defined as an activity or relationship with another company or individual that would result in questionable ethics, would not be in the best interest of KSBE, would result in personal profit or advantage to a Trustee.

2. Conflicts of Interest arise if a Trustee enters relationships, takes action or establishes an economic interest for the Trustee's or another's personal gain which compromise the Trustee's ability to represent KSBE's best interest. This includes Immediate Family or any other relationships which might (or might be construed to) appear to be a motive to unfairly influence or take advantage of business matters involving KSBE.

3. Conflicts of Interest are also defined to include any unauthorized use or application of any confidential or proprietary information (information which is the property of KSBE) to the detriment of KSBE, especially where this results in personal gain to the Trustee, his/her Immediate Family, friends or any other person or entity in which the Trustee has a personal interest, either directly or indirectly.

B. **Immediate Family** means a Trustee's spouse, father, mother, children, brothers, sisters and grandchildren; the father, mother, brothers and sisters of such Trustee's spouse; and the spouse of a child, brother or sister of such Trustee.

II

Situations Which Could Lead to Trustee Conflicts of Interest

A. Personal Interest in Contract or Transaction

When a Trustee has a financial or personal interest in a contract or transaction to which KSBE is also a party, or has actual knowledge of an Immediate Family member having such interest, the Trustee may have an actual or potential Conflict of Interest.

B. Directors, Officers, or Trustees in Common With the Other Organization

When KSBE enters into a contract or transaction with another organization in which a Trustee simultaneously serves as a director or officer of the other organization, or an Immediate Family member of a Trustee simultaneously serves as a director or officer of the other organization and such Trustee has actual knowledge of such Immediate Family member's position or title, the Trustee may have an actual or potential Conflict of Interest.

A limited exception applies where a Trustee serves as a director or officer of an organization that is, directly or indirectly, owned or controlled by KSBE, or where a Trustee serves in such capacity at the request of (or upon election by) the other Trustees.

C. Corporate Opportunity

A corporate opportunity issue arises when a Trustee pursues, or has actual knowledge of an Immediate Family member pursuing, an investment opportunity in which KSBE may also have an interest.

Under certain circumstances, the Trustee should make such investment opportunity available to KSBE before the Trustee or Immediate Family member pursues the opportunity for his or her own account. Whether such opportunity must first be offered to KSBE will depend on such factors as:

1. the circumstances in which the Trustee became aware of the opportunity,

2. the degree of interest of KSBE in the opportunity,

3. whether the opportunity relates to KSBE's business, and

4. whether there is a reasonable basis for KSBE to expect that the Trustee should make the opportunity available to KSBE.

Trustees shall not knowingly participate in investments in which KSBE or any of its subsidiaries are parties; except for publicly-traded companies in which neither KSBE, its subsidiaries, the Trustees nor any combination of them will have a 5% or more interest and where such investment is not otherwise prohibited by applicable law or securities regulation. Provided, however, that this shall not preclude a Trustee's personal investment in mutual funds and similarly pooled investments nor KSBE's investment in publicly traded companies where such investments are made and monitored by independent investment managers.

D. Gifts, Gratuities, Excessive Entertainment

A Conflict of Interest may arise if a Trustee receives gifts, gratuities, or excessive entertainment from any company with which KSBE has or is contemplating business dealings.

The Trustee should return any such gifts. If immediate return is not practical, they should be given to KSBE for charitable disposition or such other disposition as the Board feels appropriate. Trustees are urged to make this policy known to those with whom the Trustees deal so that these situations do not arise.

Note: Exceptions include gifts involved in cultural exchanges or nominal tokens of friendship, especially on special occasions. Gifts in this category should normally not exceed the IRS business deduction of $25.

E. Confidential, Proprietary, or Privileged Information

A Conflict of Interest may arise if a Trustee takes advantage of proprietary or confidential information obtained through KSBE which results in personal gain for the Trustee, his/her Immediate Family or friends, or related entity, or using this information against the best interest of KSBE.

Release of confidential and/or non-public information regarding KSBE or obtained through KSBE is prohibited unless approved by the Board. If a Trustee gives speeches or interviews, or prepares articles which might contain sensitive and/or confidential information, he/she should clear such items with the Board prior to release.

F. Political Activities

1. Trustees may support political parties and candidates of their choice on their own time and with their own money. KSBE staff and assets, including stationery, letterhead, logo, equipment, supplies, vehicles, and facilities shall not be used for promotion of specific candidates.

2. If a Trustee supports political parties or candidates, he/she must affirmatively disclose, whenever appropriate, that the political views are his/her own and not in any way a representation of KSBE's position. It is the Trustee's responsibility to make certain that no misunderstanding or misrepresentation occurs which may lead another to believe that his/her views represent those of KSBE.

3. If a Trustee is nominated to serve on a public commission or board, he/she should review the situation with the Board prior to making formal application or accepting an appointment. This review will ensure that the Trustees' paramount obligation to KSBE will not be compromised.

III

Guidelines to Address Trustee Conflicts of Interest

Trustees should clearly avoid any potential or actual Conflict of Interest. The following guidelines and procedures should be applied in the event a potential or actual Conflict of Interest arises.

A. Disclosure of Material Facts at a Board Meeting

1. The Trustee who may have an actual or potential Conflict of Interest (the "Conflicted Trustee"), should inform the non-conflicted Trustees (the "Non-Conflicted Trustees") of all relevant facts and circumstances.

2. The Conflicted Trustee is responsible to disclose all material facts concerning an actual or potential Conflict of Interest involving the Conflicted Trustee, or the Conflicted Trustee's Immediate Family member of which the Conflicted Trustee has actual knowledge, at a Trustees' meeting as soon as such potential or actual Conflict of Interest is discovered, and before any action is taken on the contract or transaction.

3. After disclosure of the interest and all material facts, the Conflicted Trustee should leave the Board meeting. No contract or transaction between KSBE and a Conflicted Trustee or a Conflicted Trustee's Immediate Family member shall be permitted unless the Non-Conflicted Trustees, having full knowledge of the disclosure, approve the contract or transaction by a requisite vote.

4. Minutes of the Board meeting should accurately reflect the disclosure made by, and the non-participation of, the Conflicted Trustee (see Article V, Records of Proceedings).

B. Review of the Fairness of the Transaction

1. To be valid, contracts or transactions which involve one or more Trustees, or one or more of a Trustee's Immediate Family, must be considered "fair and reasonable" to KSBE in the judgment of the Non-Conflicted Trustees by a requisite vote after a complete and objective review of all of the material terms of the contract or transaction. To be **"fair and reasonable"** the consideration and terms of the contract or transaction must be at least as favorable to KSBE as it would have been in an arms-length transaction with an unrelated third party.

2. A Conflicts of Interest review is required when there are contracts or transactions between:

   a. KSBE and one or more of its Trustees or their Immediate Family members;

   b. KSBE and any other organization in which one or more Trustees or their Immediate Family members have a financial interest; or

   c. KSBE and any organization for which one or more Trustees or their Immediate Family members simultaneously serves as a member of the organization's board of directors or as an officer.

C. Obtain Court Approval

Any provision of this Conflicts Of Interest policy notwithstanding, if the duty of a Trustee and the Trustee's individual interest or the Trustee's interest as trustee of another trust, conflict in the exercise of a trust power, the power may be exercised only by court authorization (except as provided in Section 554A-3(c)(1), (5), (17, and (23), Hawaii Revised Statutes, upon petition pursuant to Section 554A-5(b), Hawaii Revised Statutes.

IV

Violations of the Conflicts of Interest Policy

A. If any Trustee has reasonable cause to believe that another Trustee has failed to disclose actual or potential Conflicts of Interest, he/she shall inform the suspected Trustee of the basis for such belief and afford the suspected Trustee an opportunity to explain the alleged failure to disclose.

B. If the suspected Trustee believes that no actual or potential Conflict of Interest exists, and if no resolution is reached, the Trustee shall petition for instructions pursuant to Section 554A-5(b), Hawaii Revised Statutes.

C. If any Trustee determines that the suspected Trustee has in fact knowingly failed to disclose an actual or potential Conflict of Interest, he or she shall petition for instructions pursuant to Section 554A-5(b), Hawaii Revised Statutes. If the failure to disclose is unintentional, the Trustee shall inform the Non-Conflicted Trustees of the matter at a Board meeting and the Non-Conflicted Trustees promptly shall take appropriate action to address the Conflict of Interest, including, if warranted, by filing a petition pursuant to Section 554A-5(b), Hawaii Revised Statutes, and shall ensure that such failure to disclose does not recur.

V

Records of Proceedings

The minutes of the Board meeting shall contain:

A. the name(s) of the Trustee(s) who disclosed or otherwise were found to have a personal or financial interest in connection with an actual or potential Conflict of Interest, the nature of the personal or financial interest, any action taken to determine whether a Conflict of Interest was present, and the Board's decision as to whether a Conflict of Interest in fact existed.

B. the names of the persons who are present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection therewith.

VI

Disclosure of Financial and External Activities

Annual Disclosure

A. All Trustees annually must complete a "Trustees' Disclosure of Financial Interests and External Activities" form. This disclosure form includes information on all actual or potential Conflicts of Interest involving a Trustee, or those involving a Trustee's Immediate Family member of which the Trustee had actual knowledge, and an itemization of all existing directorships and offices held in any corporate entity, whether for profit or not for profit.

B. As new Trustees join the Board, he or she will complete the "Trustees' Disclosure of Financial Interests and External Activities" form.

C. Completed "Trustees' Disclosure of Financial Interests and External Activities" forms shall be retained by KSBE's Internal Auditor and copies shall be available upon request for review by the Attorney General as *parens patriae* and the court-appointed master.

KAMEHAMEHA SCHOOLS BERNICE PAUAHI BISHOP ESTATE

TRUSTEE'S ANNUAL DISCLOSURE OF FINANCIAL INTERESTS AND EXTERNAL ACTIVITIES

Part VI of the Conflicts of Interest Policy for the Board of Trustees of the Kamehameha Schools Bernice Pauahi Bishop Estate (the "Conflicts Policy"), requires that all Trustees annually complete a disclosure that includes information on all actual or potential conflicts of interest involving the Trustee, and those involving the Trustee's Immediate Family member of which the Trustee has actual knowledge, and an itemization of all existing directorships and offices held by the Trustee in <u>any</u> entity, whether for-profit or not-for-profit.

Completed disclosure statements are given to KSBE's General Counsel and retained by the Legal Group as attorney-client privileged communications. Copies are provided annually to the Court-appointed Master and may be subject to review by the Attorney General of the State of Hawaii as *parens patriae*.

The undersigned Trustee has received, read and reviewed the Conflicts Policy and, in compliance with the Conflicts Policy, makes the following disclosures and representations to General Counsel and the Court-appointed Master:

A. All existing directorships and offices held by the undersigned Trustee in <u>any</u> entity, whether for-profit or not-for-profit, are enumerated on the attached page.

B. All actual and potential conflicts of interest, as defined in the Conflicts Policy, which involve the undersigned Trustee or the undersigned Trustee's Immediate Family (as defined in the Conflicts Policy) and, in the latter case, of which the undersigned Trustee has knowledge, are described on the attached page.

C. To the best of my knowledge, information and belief, (i) KSBE has not entered into any transactions with me, members of my Immediate Family (as defined in the Conflicts Policy) nor with entities, organizations or businesses with which I or members of my Immediate Family are affiliated or in which I or members of my Immediate Family have an interest except such as are fully and fairly disclosed on the attached page(s); (ii) any such transactions were made for full and fair consideration as if the affiliation or interest did not exist, and only after full disclosure by me to General Counsel and to the Board of Trustees of the material facts of the affiliation, interest or relationship; and (iii) I did not participate or assist in or influence in any manner the negotiation, presentation, and decision-making concerning the transaction and its circumstances.

Signature ______________________________ Date ______________

Print Name ____

RBG/241447.02

TRUSTEE'S ANNUAL DISCLOSURE OF FINANCIAL INTERESTS AND EXTERNAL ACTIVITIES

STATEMENT OF ACTUAL OR POTENTIAL CONFLICTS OF INTEREST

The following statement describes all actual or potential conflicts of interest, as defined in the Conflicts of Interest Policy, which involve (i) the undersigned Trustee or my Immediate Family (of which I have knowledge) and identifies the persons or entities involved, the nature of the actual or potential conflict, and other relevant information. (Examples: Trustee's son John Smith holds a KSBE industrial property lease, TMK 1-1-1:01; Trustee's daughter Mary Jones owns a KSBE leasehold apartment in the ABC Condominium; Trustee's niece Jane Doe is an attorney with Lee & Lee, which represents KSBE in various matters; Trustee is a shareholder in XYZ, Inc., which provides landscaping services to Royal Hawaiian Shopping Center; Trustee is a limited partner in ZZZ Limited Partnership, which operates a chain of retail stores known as "Z's", with an outlet at Windward Shopping Center.)

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Signature

TRUSTEE'S ANNUAL DISCLOSURE OF FINANCIAL INTERESTS
AND EXTERNAL ACTIVITIES

SCHEDULE OF ALL EXISTING DIRECTORSHIPS AND OFFICES HELD

Entity Name	Office Held	Compensated?	Nature of Entity's Business	Is the Entity For Profit or Not For Profit?	Does the Entity Do Business with KSBE?

Signature

Kamehameha Schools Bishop Estate

Spending Policy

(August 18, 1999)

KAMEHAMEHA SCHOOLS BISHOP ESTATE

Spending Policy

I. Introduction

This memorandum provides a summary of the policy guidelines the Trustees have adopted governing annual distributions from KSBE's investment assets ("the Trust") to support the Trust's tax-exempt purpose to fund educational programs.

The rationale for the proposed spending policy is discussed below in more detail, however, the Trustees considered five critical factors as they developed this policy:

1. KSBE is a perpetual institution, hence it is critical that the value of the Trust net of spending distributions and expenses must at least keep pace with inflation. Real growth in the value of the Trust would enable KSBE to expand its programs over time. This is consistent with maintaining Financial Equilibrium[1] which is a fundamental objective of KSBE's financial policies.

2. The Trust is virtually the only source of revenue for KSBE's educational programs. The Schools charge minimal tuition and receive minimal gift revenues to off-set a possible decline in Trust distributions.

3. Once established, program operating costs are relatively stable while investment market values are volatile. Hence, the Trust's spending policy must enable the Trustees to maintain a relatively stable distribution to programs regardless of market value volatility.

4. KSBE is in the early stages of a significant program expansion that will increase program operating expenses over the long-term and require significant capital investment over the next several years.

5. KSBE is also in the process of revising the Trust's investment strategy. Fully implementing the revised strategy will take several years as many of the Trust's investments are illiquid.

The proposed Trust spending policy recognizes KSBE's perpetual time horizon, the Trust's role as the dominant source of revenues for KSBE's educational programs, the need to moderate the

[1] Financial Equilibrium is a conceptual framework developed for evaluating the long-term financial stability of non-profit organizations. In summary, an institution is said to be in Financial Equilibrium if it at least satisfies the following conditions: 1) limits spending from its endowment assets to a level that will at least preserve the purchasing power of the endowment over the long-term; 2) spends or reserves adequate funds to preserve the useful life of its physical assets, such as physical plant and equipment including technology; 3) balances its current operating budget, consistent with at least satisfying conditions 1 and 2; and 4) establishes policies to keep the growth of revenues and expenses in balance while still at least satisfying conditions 1 and 2. Over time, a fifth condition has been added to the framework: an institution must invest adequate resources in its program to at least maintain its "Quality" relative to its peer group.

volatility of investment markets and KSBE's need for flexibility to adjust for significant expansion of KSBE's programs and changes in the Trust's investment strategy.

II. Proposed Trust Spending Policy

KSBE will establish a Spending Policy for the Trust comprised of two components. The first component is to spend all net income from Agricultural and Conservation Lands. The second component is to establish a Target Spending Rate of 4.0% of the average market value of KSBE's "Endowment". KSBE expects that its actual Endowment Spending Rate will vary from year-to-year in a range of 2.5% to 6.0% of the Endowment's average market value.

The Endowment will consist of KSBE's investment assets, including the assets of all subsidiaries and affiliated organizations on a fully consolidated basis, but excluding Agricultural and Conservation Land assets and Operating Reserve and Technology and Capital Expense Reserve funds if established by the Trustees. The Endowment's average market value will be calculated as the average market value of KSBE's Endowment as of the end of the prior five fiscal years ending June 30. Over time, the Endowment's average market value will be calculated based on market values as of the end of the prior 20 calendar quarters. Endowment spending distributions will be cash-basis expenses for capital, operating and administrative costs of KSBE's educational programs, but will not include investment-related expenses. Investment-related expenses will be charged against the Endowment's investment return. **A detailed description of the methodology for calculating the Endowment Spending Rate is attached as Appendix 1.**

KSBE's Agricultural and Conservation Land assets have been excluded from the Endowment and the calculation of the Endowment Spending Rate. These Land assets have earned only a minimal net income or have operated at a slight loss. KSBE will spend all net income derived from Agricultural and Conservation Land assets on educational program expenses. Net income, for the purposes of this policy, will be defined as revenue generated by Agricultural and Conservation Land assets less KSBE's costs related to the management and up-keep of these assets. KSBE may reinvest net income generated in one year if it is required to off-set deficits generated in prior years. The Trustees will periodically review the Agricultural and Conservation Land assets to determine whether they should be reclassified as part of the Endowment.

The Trustees may also create an Operating Reserve fund and a Technology and Capital Expense Reserve Fund to provide working capital for program expenses and to create a vehicle for funding capital expenses on a stable basis over time, consistent with maintaining Financial Equilibrium. If created, these reserve funds will be maintained at reasonable levels necessary to fulfill their purposes. The Reserve funds are not considered part of the Endowment. They have shorter investment time horizons and corresponding investment objectives. Contributions from the Endowment to Reserve funds are considered Endowment Spending, but withdrawals from Reserve funds to pay for program expenses are not considered Endowment Spending (see Appendix 1 for a definition of Endowment Spending).

The Endowment's actual spending rate is expected to vary annually around the 4.0% policy target depending on program needs and changes in the Endowment's average market value. For example, capital expense needs may result in higher expenses in some years than in other years and the spending rate will likely increase during periods of low or negative investment returns and decrease during periods of above-average investment returns. **However, KSBE will make**

every effort to ensure that actual spending from the Endowment in any one fiscal year will not fall below 2.5% or exceed 6.0% of the Endowment's average market value.

The Trustees will review this Policy at least every five years to ensure that it continues to achieve its intended objectives.

III. Discussion

KSBE has adopted an Investment Return Objective for its Endowment of inflation plus 5.0%, net of investment-related expenses. Long-term historical investment return data suggest that this is a relatively aggressive objective, particularly for a fund with a large allocation to long-term land leases. If KSBE is to preserve the real value of the Endowment and maintain Financial Equilibrium, the average spending rate from the Endowment must not exceed the Endowment's average annual real investment return.

The proposed Target Spending Rate of 4.0% is 1.0% below the 5.0% real Investment Return Objective for several reasons. A lower Target Spending Rate provides an opportunity for modest real growth of the program activities over time. It also provides a hedge against the possibility that the Endowment's actual investment returns may fall short of the 5.0% real return objective or that expenses for KSBE's programs may increase somewhat faster than the general rate of inflation for a sustained period. Finally, adopting a Target Spending Rate somewhat below the Investment Return Objective is appropriate, as the Trust is virtually the sole source of revenues for KSBE's educational programs. Unlike most of its peers, KSBE charges minimal tuition and does not receive donations from its alumni.

KSBE expects that actual spending from the Endowment will vary from year to year around the Target Spending Rate reflecting fluctuations in program expenses, especially capital expenses, and volatility in the Endowment's average market value. Hawaiian real estate values have been quite volatile, rising rapidly in the 1980's and falling in the 1990's. Even diversified college and university endowment fund average real returns have been volatile over rolling five-year periods, ranging from about –4.9% per year in the FY 1973-74 period to 11.9% for the FY 1994-98 period (sources: National Association of College and University Business Officers and Cambridge Associates, Inc.). Reflecting the possible volatility of expenses and investment market values, the proposed policy includes upper and lower limits on annual spending distributions of 6.0% and 2.5% of the Endowment's average market value. **KSBE will commit to make every effort to ensure that the Endowment Spending Rate falls within the 2.5% to 6.0% range each fiscal year.**

IV. Conclusion

The proposed Endowment Spending Policy reflects an appropriate balance between supporting current educational programs and preserving the Endowment's ability to support future programs in perpetuity. The Endowment Target Spending Rate of 4.0% is appropriate as the Trust is essentially the only source of revenue for KSBE's educational programs. The policy spending rate range of 2.5% to 6.0% provides a reasonable level of flexibility for KSBE to adjust to changes in program needs and investment market conditions.

KSBE has initiated a substantial expansion of its educational programs and is evaluating additional initiatives. However, the Trustees are also cognizant of their responsibility to preserve the ability of the Endowment to support KSBE's future educational programs in perpetuity. The proposed Endowment Spending Policy provides a reasonable framework for the Trustees to balance the needs of current and future generations of students consistent with a policy of Financial Equilibrium.

Appendix 1

Endowment Spending Rate Methodology

1. General Description

The Endowment Spending Rate for a given fiscal year will be calculated by dividing the Endowment Spending Amount for that fiscal year by the Endowment's Average Market Value over the preceding five years.

The Endowment Spending Amount is the amount withdrawn from the Endowment to fund educational program expenses during a fiscal year. Educational program expenses will include operating, capital and administrative support expenses related to program activities. Only investment-related expenses will be excluded. Expenses will be calculated on a cash-basis.

The Endowment includes all of KSBE's investment assets on a fully-consolidated basis except for Agricultural and Conservation Land assets, and Operating Reserve and Technology and Capital Expense Reserve Funds that may be created by the Trustees to maintain Financial Equilibrium. The Endowment investments generally will be valued at the most recently available market values as of the valuation date less any debt used to finance Endowment investments. The average of the Endowment's market values over the most recent five years will be used as the denominator in calculating the Endowment Spending Rate.

2. Endowment Spending Amount

The Endowment Spending Amount is defined as all withdrawals from the Endowment during a fiscal year to fund program-related expenses. Program-related expenses include all operating, capital and administrative support services related to KSBE's program objectives. In general, program-related expenses are all KSBE expenses except those required by investment activities. Investment-related expenses should be charged against the Endowment return and not treated as Endowment Spending. Support service expenses (computer, legal, personnel, accounting/budgeting etc), fringe benefits (medical, FICA, retirement, etc.) and any other indirect expenses should be allocated between program and investment functions using a consistent, fair methodology, such as staff headcount, estimated staff time allocations and office space utilization.

The Endowment Spending Amount is generally defined as cash-basis withdrawals from the Endowment to fund program-related expenses during a fiscal year. Program expenses funded by net income from Agricultural and Conservation Land assets, tuition, gifts or other non-endowment sources are considered spending for program purposes but are excluded for the purposes of calculating Endowment Spending under this policy as defined.

If KSBE borrows funds to pay program-related capital or operating expenses, principal and interest debt service payments would be considered part of the Endowment Spending Amount at the time those payments are made. However, program-related expenses paid with the proceeds of the borrowing would not be considered Endowment Spending.

Payments made for program purposes by the Endowment in the form of in-kind exchanges are considered Endowment Spending. For example, if KSBE exchanges land held as an investment in the Endowment for land to be used for educational programs, the value of the land exchanged should be considered Endowment Spending. Investment land donated by the Endowment directly to educational programs for program use should also be considered Endowment Spending.

Contributions from the Endowment to create or supplement an Operating Reserve or a Technology and Capital Expense Reserve fund would be considered Endowment Spending in the year these transfers are made. Withdrawals from these Reserve funds to fund program expenses would not be considered Endowment Spending. For example, the Trustees may decide to make regular contributions to a Technology and Capital Expense Reserve which will then be drawn down to fund educational technology and physical plant renewal expenses. The transfer from the Endowment to the Reserve fund would be considered Endowment Spending at the time it is made, but the withdrawal from the Reserve to fund the plant renewal expense would not. Transfer of surplus funds from a Reserve fund back to the Endowment would be deducted from Endowment Spending in the year the transfer is made. Reserves shall be maintained at levels adequate to maintain Financial Equilibrium, but excessive Reserves will be avoided.

3. **Endowment's Average Market Value**

The Endowment's Average Market Value will initially be defined as the average of the Endowment's Market Value as of June 30 of the prior five fiscal years. For example, the spending rate for FY2000 will be based on the Endowment Spending Amount for FY2000 divided by the average of the Endowment's market values as of June 30, 1995, 1996, 1997, 1998 and 1999. Over time, the definition will change from five annual market values to the average of the most recent 20 quarterly Endowment Market Values ending on December 31 of the year preceding the fiscal year. The purpose of ending the averaging period six months prior to the start of the fiscal year is to facilitate the budgeting process.

The Endowment includes all of KSBE's investment assets on a fully consolidated basis, excluding only Agricultural and Conservation Land assets and Reserve funds created by Trustees. Assets used for or designated for program-related activities, such as educational plant and equipment, administrative office space and land designated for educational program use are not considered to be investment assets.

The Endowment's Market Value is calculated netting out all debt used to finance Endowment investments.

All Endowment assets will be valued at, or as close as practicable to, their current market values as of the valuation date. Guidelines for valuing various types of investments established by the Association of Investment Management and Research should be adhered to as closely as possible and will be consistently applied. Since most of KSBE's land assets have been valued in the past based upon tax-assessed values, there will necessarily be a transition period before all assets can be reported at fair market values. During this transition period, KSBE will move as quickly as practicable towards fair market values based upon independent appraisals and other appropriate methods.

In general, marketable security assets should be valued at their most recent selling price. Restricted securities or large block positions may be discounted from the most recent selling price with the size of the discount depending on the nature of the restriction and the size of the block. Private venture capital investments (which generally do not have established earnings) should be valued at the lower of cost or market value determined by the General Partner responsible for the investment. The General Partner may reduce the carrying value of a venture capital investment if it is performing poorly relative to its business plan, but may not increase its carrying value until a transaction with a third-party has validated a higher valuation. Private equity investments in established businesses should generally be valued using the same criteria as applied to venture capital investments. However, in the case of longer-term private equity investments with established asset values and/or earnings, the carrying value may be increased by the General Partner based on a conservative assessment of comparable public valuations of similar enterprises. Real estate investments should be valued at the most recent appraised value provided by a qualified, independent appraiser. The General Partner responsible for the investment may reduce the carrying value between appraisals if the property's performance or market conditions deteriorate.

It may not be practicable for KSBE to commission appraisals for all of its Hawaiian real estate assets. KSBE will have its Commercial properties appraised every three years and will evaluate the feasibility of appraising its larger income producing land investments. Adjusted Tax Assessed valuations may be used for assets that are not appraised. Private real estate mortgages, or purchase money mortgages, may be discounted from their carrying values based on their current income yield, credit quality and liquidity. Mainland real estate investments will be valued at the lower of cost or market value estimated by the responsible General Partner until these assets can be appraised by a qualified, independent appraiser or sold. Mainland real estate assets that are intended to be held as long-term investments should be appraised every three years.

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ATTACHMENT 11

METHOD OF COMPENSATION OF TRUSTEES

A method of compensation has been approved by the Probate Court for establishing Trustee compensation through an independent Compensation Committee. This method is set forth in Attachment 11-A. After the CEO is in place and following an appropriate transition period (not to exceed two years), KSBE will submit a Ruling Request to the IRS seeking approval for a method for determining Trustee compensation going forward. KSBE will provide a copy of its Ruling Request and any IRS Ruling issued in response to its request to the Master, the Attorney General and the Probate Court.

ATTACHMENT 11-A

To be provided once a method of compensation has been approved by the Probate Court for establishing Trustee compensation.

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ATTACHMENT 12

METHOD OF COMPENSATION OF CHIEF EXECUTIVE OFFICER

The compensation of the CEO will be set by the Board of Trustees in consultation with a nationally recognized compensation consultant, who will make recommendations based upon compensation paid for functionally comparable positions in comparable non-profit organizations. KSBE will provide annual reports to the IRS identifying the amount of compensation paid to the CEO in the prior year and the amount of compensation that will be paid to the CEO for the next year. Based on its review of this information, the IRS may require KSBE to submit a Ruling Request proposing an alternative methodology for setting CEO compensation.

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ATTACHMENT 13

KSBE AND KSBE ORGANIZATIONS PROCUREMENT GUIDING PRINCIPLES

This statement applies to the Kamehameha Schools Bishop Estate ("KSBE"), Kamehameha Activities Association ("KAA") and to all entities within the Consolidated Group (KAA and the Consolidated Group are collectively referred to as "KSBE Organizations").

It is the policy of the KSBE and the KSBE Organizations to obtain supplies, services, equipment, and facilities through purchase, contract or lease to meet the various requirements at the most reasonable and competitive prices following established, prudent business practices. Procedural responsibilities should be appropriately divided to ensure that good internal controls are maintained and practiced.

Purchasing and Contracting Objectives

A. Goods, Supplies and Other Tangible Products

1. Obtain the maximum value for goods acquired through competitive bidding, price quotes and volume contract pricing. Where and when justified, utilize sole sourcing agreements with vendors to increase value and service to the organization.

2. Achieve an appropriate balance between control and efficiency to emphasize procurement efforts on large dollar, complex and organization-wide transactions.

3. Conduct business with reputable and qualified vendors by conducting thorough and periodic reviews of vendor qualifications, performance and solvency.

4. Educate, inform and assist organizational users on procurement policies, procedures and concepts to assure consistent procurement practices.

B. Professional Services

1. Obtain services from the most qualified and competitively priced vendor from a list of pre-qualified vendors (where practicable). Consideration must also be given to past vendor performance, vendor stability, availability and uniqueness of the service being provided.

2. A list of reputable and qualified vendors will be developed and maintained by conducting thorough and periodic reviews of vendor qualifications, performance and solvency.

Use of Standard Process

All purchasing, contracting and leasing regardless of cost must follow the established procurement process, to include a review of possible alternative products and sources; review of total cost of purchase to include replacement cycle, maintenance cycle, etc.; and documentation and justification of the selection within a bidding process. Exceptions to this bidding process will occur only in limited situations (that will be defined in each company's procurement policies). Exceptions to this bidding process will be clearly defined. Should exceptions occur, documentation will be maintained setting forth the specific facts. The decision and related documentation will be approved pursuant to a system that ensures appropriate internal controls.

Service Provider Qualifications

The qualifications of all service providers (consultants, outside counsel, etc.) must be verified prior to the awarding of a contract by the unit most capable and appropriate in determining such qualifications. The contracting unit is responsible to ensure that this verification process has occurred in an objective manner and thus provides good internal control. The verification check will include, but not be limited to:

- obtaining information related to the education, training and work experience of key members
- seeking referrals from other clients about performance record to include overall quality of product and/or quality of services – dependability, flexibility, follow-up, timeliness and ease of the invoicing process
- verifying the financial solvency of the person or firm
- observing all applicable policies relating to, and in prevention of, any conflicts of interest between the staff member/Trustee and the service provider.

Additional responsibility for segregation of duties must be established to ensure that good internal control practices are followed:

- Responsibilities for purchasing, receiving and payment will not reside within the same authority.
- Independent verification of procedures will be conducted periodically by the internal auditor.

August 12, 1999