

Broken Trust: Greed, Mismanagement & Political Manipulation at America's Largest Charitable Trust

by Samuel P. King and Randall W. Roth

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Stories about investigations into abuses in the tax-exempt sector are usually limited to accounts of the misappropriation of funds, board member resignations, IRS sanctions, and various financial minutiae. But, when an investigation centers on a charity that is one of the last bastions of a hermetic island's ethnic heritage, and on top of that has an endowment of \$10 billion, the stakes — and the ensuing drama — are heightened considerably.

Broken Trust: Greed, Mismanagement & Political Manipulation at America's Largest Charitable Trust chronicles the judicial and IRS investigations into Bishop Estate, a charitable trust established by a Hawaiian princess to create and maintain Kamehameha Schools, a system of private schools set up to educate primarily native Hawaiians. The book, by Samuel P. King and Randall W. Roth, includes tales of political corruption, suicide attempts, and death threats, which is to say it's not limited to the normal machinations of stories that usually appear in *The Exempt Organization Tax Review*. Framed within a social-historical backdrop that details Hawaii's proud native culture, its hesitant annexation by the United States, its suspicion of *haoles* (a Hawaiian word for outsiders), and its insular politics, *Broken Trust* provides the requisite backdrop for a story about a charity that was allowed to operate unfettered by the checks and balances that regulate most charities on the mainland.

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Princess Pauahi, who later would be known as Princess Bernice Pauahi Bishop, served as a bridge between Hawaii's native past and its Western-influenced future. The Hawaiian princess was educated at the Royal School, an institution run by Protestant missionaries for native Hawaiians, where she wholeheartedly immersed herself in Western culture. When the princess died in 1884, she entrusted the 378,569 acres of land (the Bishop Estate) that had been bequeathed to her by various relatives — including Princess Ruth Ke'elikolani, who served as governor of Hawaii for three years — to five trustees to create and maintain Kamehameha Schools, a system of schools that were to be run in the spirit of the Royal School.

With such an exorbitant amount of real estate — and the huge amounts of revenue the estate generated from leasing and selling land — at the trustees' disposal, corruption was an all-too-tempting proposition. Al-

though the more severe abuses that would inspire *Broken Trust* did not happen until the 1990s, the authors traced trustee abuse back to 1943 when two Hawaiian senators scolded Bishop Estate trustees for receiving \$10,250 (six times the average Hawaiian full-time wage) for part-time work.

However, excessive compensation was a small transgression compared to the cornucopia of abuse that transpired at Bishop Estate in the 1990s. *Broken Trust* recounts, among other things, instances of a trustee paying an unqualified close friend \$35,000 to access the value of a collection of antique Hawaiian photographs and books, and another trustee billing the trust for 16 first class trips to Las Vegas. One Bishop Estate trustee, Henry Peters, even went so far as to negotiate what ended up being a \$40 million construction loan with a Northern Virginia golf club of which he was a board member, according to *Broken Trust*. The authors say Peters temporarily "recused" himself as a trustee of Bishop Estate during the negotiation process . . . so he could negotiate on behalf of the golf club!

One of the factors that led to this gross mismanagement and abuse, say the authors, was the selection process that was used to appoint trustees. Members of the Hawaiian Supreme Court selected the Bishop Estate trustees when they weren't presiding over the court. Judges frequently used the selection process not to appoint the most qualified candidates, but to repay legislators who had appointed them to the court. Also, candidates for the Supreme Court were being screened by the Hawaiian Judicial Selection Commission to see whom they would appoint for future vacancies on the estate's board. Therefore, when allegations of trustee abuse at Bishop Estate first emerged, it was no surprise that they were largely ignored by the court system and many powerful legislators who would serve to gain from such a process.

With so many powerful parties interested in preserving this corrupt process, it was tough for critics to find a forum to illuminate the abuses that were going on at Bishop Estate. The publication of the original essay that *Broken Trust* flowered from (which was authored by Roth and King as well as a retired Kamehameha principal, a retired judge, and a priest) was stalled by members of the press, who were fearful of the backlash they'd receive from many powerful Hawaiian public officials and the Hawaiian public, many of whom still clung on to an idealistic, sentimental image of the estate.

However, on August 9, 1997 — inspired by a wave of swinging public opinion that reached its apex on May 15, 1997, when thousands of Kamehameha staff, alumni, and other concerned citizens marched from the royal mausoleum where Princess Pauahi was laid to rest to Bishop Estate's headquarters to protest trustee mismanagement and abuse — the essay was published. The ensuing

public outcry led to a series of investigations by Hawaiian Attorney General Margery Bronster and an investigation commissioned by Bishop Estate itself, headed up by Colbert Matsumoto. Also, unbeknownst to many members of the public, the IRS had been conducting a two-year investigation into abuses at Bishop Estate. When all three investigations' findings were made public, nothing less than a total overhaul of the governance practices of the institution would save the trust's tax-exempt status.

Bishop Estate trustees, said the IRS in its report, were treating Princess Pauahi's legacy like "a personal investment club"; operating with abandon, with little concern about the trust's charitable mission. The unprecedented abuses at Bishop Estate were so egregious that the IRS initially said it had no other choice but to revoke the estate's tax-exempt status. The IRS had such a lack of faith in the manner in which the standing trustees conducted themselves that it refused to communicate with them, and a Hawaiian judge had to appoint five new "special purpose" trustees to deal with the IRS on behalf of the estate.

However, because the estate employed and served so many Hawaiians, Marcus Owens, who was then director of the IRS's Exempt Organizations Division, agreed to a compromise. If the estate agreed to certain "non-negotiable" conditions, the first of which was the immediate removal or resignation of all five permanent trustees, it could keep its tax-exempt status. In the end Bishop Estate had to totally revamp the process it used for

selecting trustees as well as its governance system, and it had to host an independent internal auditor who would report directly to the IRS during a five-year probationary period. In addition, the trust and its wholly owned companies had to pay the IRS approximately \$83 million for unreported unrelated business income and a slew of other transgressions.

Responding to his removal from the board, Henry Peters made a statement to reporters that served as a perfect example of the how much the trustees' unchecked power had gone to their heads.

"Anywhere else they would have a parade for me," said Peters. "Here they kick you in the butt and indict you."

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While many other books of its kind pay marginal attention to character exposition, the players in *Broken Trust* jump off the page. The authors spare no intimate details rendering people like Lokelani Lindsey — the cantankerous, controlling trustee who frequently intimidated Kamehameha faculty, staff, and students — and Oz Stender, the maverick voice of virtue among the five trustees.

What makes *Broken Trust* so fascinating is that it works on multiple levels. It's a well researched book about Hawaii's history and culture; a dramatic story of judicial, political, and corporate corruption; and a cautionary tale for acting or future charitable trust board members on everything you *shouldn't* do if you want to respect your organization's mission and ensure the public's trust.