PART V: PROVIDER SPECIFIC ANALYSES

SECTION ONE - PROVIDER-SPECIFIC ANALYSIS FOR ASHFORD & WRISTON

I. INTRODUCTION

Our review of the work that Robert Bruce Graham performed for the Trust Estate during the Review Period began with preliminary interviews that took place over the course of two days. We then reviewed approximately 50 boxes of Ashford & Wriston's KS client files, as well as approximately ten other boxes of documents relevant to Graham, including billing records covering the Review Period. Following our document review, we conducted more intense follow-up interviews of Graham lasting two and one-half days. We also received input from a number of other sources concerning Graham's work for the Trust Estate.

Graham began legal work for the Trust Estate in 1973, as a law clerk for a Hawaii law firm that later became Rush, Moore, Craven & Stricklin ("Rush Moore"). As an associate with this firm, Graham initially performed research assignments related to the Rush Moore firm's representation of the Trust Estate, often in conjunction with the preparation of the Trust Estate's Annual Accounts. Graham became more involved in legal matters involving the Trust Estate in 1985, after the Rush Moore partner in charge of the bulk of KS's trust work became ill. Rush Moore retained KS as a client until April 1989, when Graham gave notice and moved to the law firm of Ashford & Wriston, his current firm.

In 1989 and 1990, Graham was responsible for the ministerial aspects of filing the Trust Estate's Annual Accounts. During those years, KS staff handled the preparation of the Annual Accounts, while Graham saw that the documents were assembled and signed, and handled the filings with the Probate Court. Beginning in the mid-1990's, Graham became more involved with evaluating trust law issues for KS.

Graham stated that he advised the Trustees individually only with respect to the Trustees' duties and responsibilities on behalf of KS. Graham never prepared personal papers for the Trustees, such as a will, nor did he advise the Trustees on matters in which the interests of the Trust Estate conflicted with those of the individual Trustees.

Graham served as "Trust Counsel" to KS in the broadest sense of that title. Graham was the primary outside attorney responsible for filing the Trust Estate's Annual Accounts. In addition to working on the Annual Accounts, Graham fielded more general inquiries from the Trustees and from Nathan Aipa regarding trust law issues. Graham also prepared the majority of the Trust Estate's responses to the Masters' Reports.

In our interview of Graham, we questioned him regarding his work for the Trust Estate over the Review Period in general, but also as to specific allegations where relevant. We determined that Graham's services with respect to the following issues merit a discussion in this Report: (1) Graham's work on various questions related to Trustee compensation, including the truthfulness of testimony he gave in April 1999 that he did not know the level of Trustee compensation for the period after January 1, 1999; (2) his defense of the Trustees in connection with an order to show cause why they did not violate a stipulated order requiring them to adopt a CEO form of governance; (3) his advice to KS regarding Trustees serving as directors of corporations in which KS owned an interest; (4) his advice to the Trustees on the issue of taking commissions on final distributions of capital; (5) his advice to the Trustees concerning the accumulation of income; (6) his positions on whether he could represent the Trust Estate as an "entity"; and (7) the extent to which he represented the interests of the Trust Estate as opposed to individual Trustee interests.

II. ISSUE-SPECIFIC DISCUSSION

A. Compensation-Related Issues

In our interview, Bruce Graham stated that Trustee compensation has been discussed for decades—probably as early as the 1940's. Graham stated that any state legislative changes to the general statutory provisions governing Trustee compensation were the direct result of a concern about KS Trustee compensation. Graham tied the increased public concern about Trustee compensation to the rising levels of wealth in the Trust Estate resulting from the influx in cash from forced conversions. The more money KS had, the more interested in trustee compensation the Hawaii State Legislature became.

With respect to the levels of compensation received by the Trustees during the Review Period, Graham believed that the statutory compensation formula provided the only limit on Trustee compensation (until the formula was removed from the statute effective January 1, 1999). At the same time, Graham advised the Trustees that they would be in a better position, perhaps a position less apt to draw public scrutiny, if they always kept their compensation below the statutory limits. In this connection, Graham was generally aware of the compensation studies on Trustee compensation prepared by SCA and Towers Perrin and believed that Trustee compensation should be deemed reasonable provided it fell within the ranges established in those studies. Because Graham was not a compensation expert, he deferred to those studies for a determination of what was reasonable.

For the period after January 1, 1999, a question has been raised concerning whether Bruce Graham gave advice to the Former Trustees that their compensation should be "aggressively calculated." These words are found in two letters to the Trustees, dated February 13 and February 25, 1999, but the words must be placed in context. First, the Trustees had already filed a proposed plan with the Probate Court for determining compensation, including the appointment of an independent panel. Secondly, the two letters set out in detail the standards to be applied in determining compensation, but without expressing any opinion on what would constitute reasonable compensation. Finally, the words "aggressively calculated" must be read in the context of what the Trustees might take on a interim basis prior to a judicial determination of what was reasonable compensation. Recognizing that any interim payments could be the subject of a downward adjustment, Graham states that: "This consideration may suggest that the periodic payments should be aggressively calculated." But he goes on to state: "However, if too aggressive, the payments invite a finding that the payments were grossly excessive and, thus, a breach of trust." When read in context, it is apparent that Graham was highlighting a consideration that was likely to occur to the Trustees, while at the same time cautioning them against taking an overly aggressive position.[24]

A question has also been raised about testimony Bruce Graham gave in April 1999 at the removal proceeding for Trustees Wong and Peters. When asked whether he was aware of the level of Trustee compensation for the period commencing January 1, 1999, Graham responded that he did not recall the specific compensation amounts. In this connection, an April 29, 1999 letter from Graham to Master Matsumoto attaches internal KS memoranda detailing Trustee compensation after January 1, 1999. Graham was also copied on correspondence listing Trustee compensation after January 1, 1999. Graham claimed that when he testified in court on April 27-28, 1999, he had no recollection of the specific level of Trustee compensation in 1999. Graham stated that he does not recall reading the information provided in these materials until the day

[24] Graham also has been criticized for arguing that the state statute on trustee compensation has been preempted by the intermediate sanctions law. Although his argument may have been misinterpreted by some, his legal conclusion is the correct one; that is, if the intermediate sanctions law established a lower level of compensation than the state law, then federal law would control.

after his court testimony, when he prepared his April 29, 1999 letter to the Master. We found no evidence that contradicts his recollection in this regard.

Further, questions have been raised about Graham's appearance before Judge Chang on April 30, 1999, in which he opposed the Master's request to suspend Trustee compensation for the balance of fiscal year 1999, until the court determined an appropriate level of compensation. Again, Graham's actions must be placed in context. Graham argued during the hearing for approval of a plan for determining trustee compensation, a plan that had been the subject of negotiation with the AG and Master dating back to November 1998. To the extent he opposed suspension of Trustee compensation for fiscal year 1999, he did not question the court's power to do so, but instead expressed concern about the duration of the suspension without a ruling. Graham did not argue for any specific level of compensation and opposed the suspension only to the extent its duration was indefinite.

B. Violation of Court Order on CEO-Based Management System

Graham has been criticized because he represented the Former Trustees at the Probate Court hearing on the Court's Order instructing the Former Trustees to show cause why they failed to adopt and implement a CEO-based system of management and to hire a CEO by March 31, 1999. It is has been alleged that the Trustees failed to meet their stipulated deadline because adopting a CEO-based management system would jeopardize their compensation by undermining the collective governance and management premise on which the SCA and Towers Perrin compensation studies were based. Graham believes, however, that concerns about their compensation were not motivating the Trustees' failure to meet the Probate Court's deadline. Rather, Graham believes that the Trustees were reluctant to hire a CEO, and implement a CEO-based management system, because they did not want to relinquish their decision-making power.

As an outside lawyer for the Trust Estate, Graham did not believe that he had the power to force the Trustees to meet a deadline or to file a response. Graham stated that he reminded the Trustees of approaching deadlines, but that the Trustees had to be the ones to exercise their discretionary power to implement orders and recommendations, such as the order to hire a CEO. It was Graham's understanding that Trustee Jervis convinced some of the other Former Trustees that the Master was focused on the issue of strategic planning, not on the implementation of the CEO-based system. Graham consulted with the Master, who informed Graham that he expected the Former Trustees to comply with the court-ordered stipulation and to hire a CEO by March 31, 1999. By the time Graham determined that Trustee Jervis' information was incorrect, it was too late for the Trustees to meet the March 31 deadline. Graham stated that although the Probate Court declined to do so, he believed at the time that the Probate Court would grant the Former Trustees an extension of time within which to hire a CEO. In Graham's view, it was appropriate for him to represent the Former Trustees with respect to the show cause order and to attempt to obtain additional time for complying with the stipulation on the CEO-based system of management. We found no evidence to suggest Graham's actions were improper.

C. Advice on Trustees Serving as Directors

At the request of the Former Trustees, KS General Counsel Nathan Aipa undertook a review of the fiduciary issues relevant to Trustee Peters' services as a Mid-Ocean director. As part of Aipa's review, he asked Graham to prepare an opinion on the law applicable to a Trustee who serves a director of a corporation in which the Trust Estate has an investment. Graham issued a lengthy opinion on September 15, 1997. In his interview, Graham stated that, at the time he wrote his opinion, he was not aware of the issue of Trustee Peters' service as a director of Mid-Ocean and viewed his opinion as a general statement on the applicable law. Graham is now aware of Wayne Pitluck's factual analysis of the Mid-Ocean facts (discussed *infra*, in our provider-specific analysis of the Pitluck firm), but noted that he was not aware of it at the time he prepared his opinion. Other than writing his opinion letter and having a conversation with Aipa when the Mid-Ocean controversy arose almost a year later, Graham had no other substantive involvement with respect to this issue. Graham did not know how Aipa reconciled Graham's memorandum with the memorandum prepared by Pitluck. Once the Mid-Ocean controversy became public, Graham and Aipa agreed that the best solution was for Trustee Peters to step down as a Mid-Ocean director.

D. Opinion on Final Disbursements of Capital

A question has been raised whether Bruce Graham advised the Former Trustees that they had the power to rescind the waiver of Trustee commissions on final disbursements of capital ("FDOC"). In an August 31, 1999 decision, Judge Hirai found that a prior waiver by an earlier Board of Trustees was binding and enforceable and could not be rescinded without court approval.

We found no evidence that Graham provided written advice to the Former Trustees on their power to rescind waivers made by prior Trustees. In July of 1994, Graham was asked whether an investment of cash principal was a "final distribution" for purposes of computing Trustee commissions; in a July 7, 1994 letter, Graham advised that it was not unless the investment was in non-productive assets that were used or acquired for charitable purposes of the Trust Estate. Graham addressed a narrow question of statutory construction in his July 7, 1994 opinion and took no position with respect to rescinding prior waivers of commissions on FDOC.

In 1998, evidence emerged that certain Trustees retroactively rescinded earlier FDOC waivers in order to preserve their compensation levels for FY 1994. Graham denies any contemporaneous awareness of this retroactive change, and we have found no contrary evidence. Once these facts emerged, Graham took the position with Master Matsumoto that waivers by one

Board of Trustees were not binding on subsequent Boards. Graham based his position on his belief that the commissions had been waived by a decision of an earlier Board of Trustees, as was reflected in contemporaneous Trustee meeting minutes. Judge Hirai's 1999 decision that found the 1966 waivers of commissions on FDOC to be binding on the Former Trustees was based on the court order memorializing the 1966 Board of Trustees' decision, of which Bruce Graham had no knowledge at the time he discussed the issue with Master Matsumoto.

E. Accumulated Income

Questions have been raised about positions Graham took in connection with the accumulation of Trust Estate income. Graham issued an opinion on April 19, 1995 on the characterization of Trust Estate revenues as principal or income. Graham concluded that the Trustees were not required to expend all income, but were required to account independently for income and corpus. Graham also addressed this issue in connection with the Master's Consolidated Report on the 109th-111th Annual Accounts.

According to Graham, the Master was concerned that the accumulated income was not properly earmarked for educational purposes. Despite the dramatic increase in the Trust Estate's wealth during the late 1980's and early 1990's, the Trustees were not spending all of the Trust Estate's annual income, nor were they setting it aside for a specific purpose. When Master Matsumoto later recommended that the Trustees separately account for accumulated income and corpus, Graham encouraged the Former Trustees to adopt this recommendation as part of their stipulation with the Master and the AG that was ultimately entered by the Probate Court. We found no evidence suggesting that Graham's April 19, 1995 opinion was inappropriate or caused any harm to the Trust Estate.

F. Definition of the Client

It has been alleged that Graham took inconsistent positions regarding his representation of the Trustees and the Trust Estate. Graham first took the position that his client was all of the KS Trustees as fiduciaries and that the Trust Estate was not an "entity." Later, in an apparent turnaround, Graham espoused an entity theory of representation.

In July 1998, Graham opined that "KS is not itself an entity" and "has no legal capacity to act in its own name." In November 1998, Graham wrote to Trustee Wong on the issue of whether the Trust Estate is regarded as an entity or an aggregation of the individual Trustees for the purposes of legal representation. By this point, Graham's view had become that KS is governed by a Board of Trustees and the Board of Trustees functions as a entity governed by a majority of three. Graham stated that although he previously believed he could not act on behalf of a majority of the Trustees against the wishes of the minority, he had recently received a contrary opinion from the Office of Disciplinary Counsel of the Hawaiian State Bar. Graham explained to Trustee Wong that the Trust Estate could be regarded as an entity for ethics purposes and that he could act for the Trust Estate at the direction of the majority where the interests of the majority were not in conflict with the Trust Estate's interests. Graham attributes his change in position to the opinion he received from Disciplinary Counsel. There is no evidence that Graham was motivated by any improper intent, either to work against the minority or to protect the interests of individual Trustees.

G. Bruce Graham's Representation of KS

As KS's principal outside trust attorney, Graham was responsible for handling the Trust Estate's Annual Accounts. Graham did not have responsibility for the IRS audit, a task handled internally or by PWC and (later) by Miller & Chevalier. Graham's role in relation to the IRS audit was limited to working with the Master to resolve the conflicts issues raised by the Forms

5701 and to provide a mechanism for KS to address the Forms 5701 through an independent panel. Nor did Graham have responsibility for representing KS in the AG's investigation—that was William McCorriston's role. Graham did serve as an advisor to Nathan Aipa, along with Michael Hare and Wayne Pitluck, to assist Aipa in dealing with the simultaneous demands of the IRS audit, the AG's investigation, and the Master's review. As described in greater detail *infra* in the provider-specific analyses of the Cades and Pitluck firms, a fundamental purpose of this "Team" was to protect KS's interests.

To adequately protect KS's interests, a number of positions had to be taken. For example, as discussed *infra* in connection with our provider-specific analyses of the Cades and McCorriston firms, it was necessary for KS to seek a protective order to prevent the AG from releasing privileged and confidential Trust Estate information and documents to the public once they were disclosed to the AG pursuant to subpoenas. This measure needed to be taken because the AG consistently refused to agree to an extra-judicial arrangement that would afford the Trust Estate these protections. Similarly, when Trustee minutes were subpoenaed in the Lindsey removal proceeding, it was important to the Trust Estate to attempt to preserve the public release of privileged and confidential information.

Bruce Graham made a number of contributions to KS in the Annual Accounts review process. For example, Graham played a key role in convincing the Former Trustees to agree to the 1997 stipulations embracing the twenty-one recommendations contained in the Master's November 17, 1997 Report on the 109th Annual Account. These stipulations included authorization for the Master to hire an international accounting firm to conduct a full financial and management audit of the Trust Estate, the task ultimately performed by Arthur Anderson.

Thereafter, Graham and Aipa worked closely with Arthur Anderson to ensure its access to information required for the audit.

Graham played an equally important role with respect to the 1998 stipulations, entered into after the Master issued his Consolidated Report on the 109th-111th Annual Accounts. Here, Graham urged the Former Trustees to accept stipulations on sixteen of the Master's nineteen recommendations, including a commitment to implement a strategic plan monitored by the Master, to submit a Trustee compensation plan, and to provide for a new CEO-based management system. A seventeenth stipulation was later entered requiring progress reports to the Master on the IRS audit.

In addition to 1997 and 1998 stipulations and the implementation of those stipulations, there are other examples of Graham's significant contributions. For example, he played an important role in the petition filed in May of 1997 seeking the appointment of Judge Yim as a fact finder. At the outset of the AG's investigation in August of 1997, Graham drafted a letter for Aipa's signature emphasizing to KS's outside counsel that they were to represent the Trust Estate's interest, not individual Trustee interests. In January of 1998, Graham, at the suggestion of the Master, organized a seminar for the Former Trustees on various fiduciary issues, such as investment standards, co-investments, trustees as directors, attorney-client communications, and the treatment of individual Trustee attorneys' fees.

Against the backdrop of these accomplishments, Graham has been criticized for defending Trustee misconduct. In addition to the issue-specific matters discussed above, he has been challenged on a submission to the Master in September of 1998 in which he briefly stated (in one paragraph) that there were Trust Estate interests at stake in the intermediate sanctions lobbying effort in the 1995-96 time period. Other than that brief statement, Graham referred all questions from the Master concerning intermediate sanctions lobbying to the firm—Verner Liipfert—that handled the lobbying effort, and urged that they correspond directly with the Master. We found nothing about Graham's conduct with respect to this matter that was inappropriate or improper.

III. ANALYSIS OF POTENTIAL CLAIMS BASED ON WORK PERFORMED BY BRUCE GRAHAM

A. No Basis for Professional Liability Claim

KS does not have any professional liability claims against Bruce Graham based on the services Graham provided to the Trust Estate during the Review Period. It is our assessment that there is no evidence to support any claim that Graham breached his duty to exercise the degree of care, skill, diligence, and knowledge commonly possessed and exercised by a reasonable, careful, and prudent lawyer. To the contrary, we were impressed with the quality of his work and his efforts to act in the best interests of the Trust Estate.

We note that as a trust lawyer, Graham was keenly aware that he was entitled to assume that Trustee decisions were within the Trustees' powers. Graham approached all inquiries from KS for his assistance with this presumption in mind and rarely questioned the motivations underlying the requests. Even in those instances in which he may have privately questioned the motivations underlying a particular request for assistance, as a professional matter he was justified in performing the requested work provided there was some benefit to the Trust Estate. Furthermore, and more important for purposes of this Report, he was protected from liability in such instances under Hawaii statutory law (Haw. Rev. Stat. § 554A-7) and the applicable Rules of Professional Conduct. *See* Langbein at 13-14; Leubsdorf at 3-4.

We also found no evidence that Bruce Graham violated any of the applicable Professional Rules of Conduct, including any disclosure obligations under those rules or the

Hawaii Probate Court Rules. Graham did not know of any illegal conduct by KS Trustees or employees. To the extent the AG or others made allegations of Trustee misconduct, they were made known to the court, and Graham did not believe that he had any independent obligation with respect to allegations already before the court. Nor was Graham aware of any criminal or fraudulent conduct, in furtherance of which Graham's services had been used, that resulted in substantial injury to the financial interests or property of another. Finally, Graham did not assist the Trustees or KS employees in engaging in, or counsel them to engage in, conduct that Graham knew to be criminal or fraudulent.

B. No Basis for a Disgorgement Claim

It is also our conclusion that no claim for disgorgement exists with respect to the services that Bruce Graham provided to KS during the Review Period. Graham did not engage in any violation of the applicable standard of care, an ethical obligation, or his duties to KS. Nor do the fees that Graham charged for the work provided appear to be excessive or unreasonable. Finally, no evidence was found that Graham did work for individual Trustees or that Graham represented both the Trust Estate and individual Trustees in circumstances in which there were divergent interests. Indeed, we found no evidence that Graham ever put an individual Trustee's interests before the Trust Estate's interests or that he performed work in furtherance of an individual Trustee's interest at any time.

C. Future Retention

The decision of whether or not to engage the services of Graham in the future is a matter well within the Trustees' discretionary powers. Graham is one of the leading trust attorneys in Hawaii and has a vast knowledge of the Trust Estate as an institution and of Hawaii trust law that would be hard to replace. Were the Trust Estate to hire a replacement for Graham to serve as KS's outside trust counsel, KS would have to devote significant time and resources to assisting the new counsel in acquiring the necessary institutional knowledge to properly advise KS. This would appear to be especially true in the case of the preparation of KS's Annual Accounts.

The work that Graham has performed for KS in the past has been thoughtful, meticulous, and beneficial to the Trust Estate. We believe that Graham has a strong record of service to the Trust Estate, albeit under difficult circumstances. His work as an advisor to Nathan Aipa, along with Michael Hare and Wayne Pitluck, was designed to preserve the interests of the Trust Estate, not to serve the interests of individual Trustees. His work on the 1997 and 1998 stipulations helped bring about many important changes at the Trust Estate. Although some have been critical of Bruce Graham, the vast majority of comments received during our interviews have been highly complimentary of his work. The Trustees will want to weigh all of these factors in considering whether to use his services in the future. We found no reason that would prevent KS from retaining Graham in the future.

SECTION TWO - PROVIDER-SPECIFIC ANALYSIS FOR CADES SCHUTTE FLEMING & WRIGHT

I. INTRODUCTION

In performing our review of the Cades firm, we interviewed Michael Heihre,[25] Kelly LaPorte, Dennis Chong Kee, Mark Rousseau, Rhonda Griswold, Chris Mardakus, and Cheryl Yasunaga. We also spoke with David Schulmeister, a Cades attorney responsible for preparing that firm's response to the Richards Report, and Colleen Wong of the KS General Counsel's office to understand her views on the work that Cades performed for KS during the AG's investigation.

In all, we conducted over twenty hours of interviews and reviewed over sixty boxes of documents from Cades' KS client files and from KS's files. These documents and interviews formed the basis for our findings contained herein. Cades has represented the Trust Estate for several decades; Michael Hare worked on KS matters soon after joining Cades in 1973. The firm worked on specific matters when requested to do so by the Trust Estate; there was no general retainer agreement. Most of these specific matters included litigation, although the firm also did some real estate and tax-planning work for KS.

We determined that Cades' involvement in the following matters merits a discussion in this Report: the settlement of the Field litigation; the Trust Estate's payment of Milton Holt's legal expenses incurred during the federal government's investigation of Holt; the Master's Review; the research into Judge King's statements adverse to KS; the Harmon injunction; the

[25] During the Review Period, Heihre spelled his last name "Hare"; recently, however, he changed the spelling of his last name. The spelling of his name in this Report will depend on the time period being discussed.

AG's investigation; document production for individual Trustees; and the IRS audit. Finally, Cades played small roles in several other controversial matters, which we also discuss.

II. ISSUES IMPLICATED BY WORK PROVIDED BY CADES

A. Hare's Initial Work for KS

Hare joined the Cades firm in 1973, after graduating from law school. Almost immediately, he began working on KS matters. The first issues he worked on for KS related to the Trust Estate's tax-exempt status and the Schools' admissions policy. Also in his first few years at Cades, Hare worked on potential sales of KS land and a petition to the Probate Court regarding the establishment of RHSCI as a taxable subsidiary of the Trust Estate.

Beginning in the early 1980's, Hare represented the Trust Estate in a dispute concerning construction work on the shopping center. This led to Hare working on various tenant disputes for RHSCI during the mid-to-late 1980's. Dick Wong (from RHSCI) worked with Hare on these matters, and arranged for Hare to meet Aipa. After meeting with Hare, Aipa asked Hare to represent KS on some small commercial lease disputes. Hare did this work for some time, and obtained favorable results for the Trust Estate. Hare also began working on various litigation matters, again obtaining results favorable to KS.

In the early 1990's, public outcry over larger landowners controlling substantially all of Hawaii's leasehold interests precipitated a series of lease condemnations by the State. Hare challenged a number of condemnation ordinances on behalf of the Trust Estate, winning many of these challenges. Hare also worked on lease-to-fee conversion litigation and was successful in obtaining fair value for KS's fee interests. Hare handled approximately ten to twelve lease-to-fee conversion cases during the 1990 to 1991 time frame. In addition to the lease-to-fee cases, Hare worked on a number of rent control matters during the 1990 to 1991 time period. Hare's duties consisted primarily of opposing rent control (as with forced conversion), which was perceived as adverse to the Trust Estate's interest. Hare obtained successful results for the Trust Estate in the rent control matters as well. Hare worked on these lease-to-fee conversion and rent control matters until approximately 1994 or 1995.

B. Settlement of the Field Litigation

The Field litigation commenced in October 1995. Field, an investor in the Trust Estate's Montrose investments, sued KS for, *inter alia*, fraud with respect to KS's original loan to Field as well as the restructuring of that debt. Field's complaint sought approximately $100 million dollars in actual, treble, and punitive damages.

Through specific retention agreements, Cades assisted Morrison & Foerster, which acted as lead counsel, in representing KS in the Field litigation and settlement. Cades was responsible for document production during the litigation, and drafted some of the later pleadings. Hare and LaPorte also assisted Morrison & Foerster in developing and negotiating a settlement. Cades' increased involvement was at the specific request of Nathan Aipa.

In October 1997, before KS settled the Field litigation, Cades and Morrison & Foerster analyzed the proposed settlement and prepared memoranda evaluating the settlement and discussing the relevant factors to be considered. At the time of the settlement, Field owed the Trust Estate roughly $44 million. The settlement called for Field to pay the Trust Estate almost $33 million in cash immediately, thereby reducing the amount of Field's liability to the Trust Estate. For a number of reasons, Cades and Morrison & Foerster decided that this settlement was in the Trust Estate's best interest. First, a settlement would provide the Trust Estate with immediate cash. Absent the settlement it was unclear whether the Trust Estate would receive the full amount due, or what the timing of Field's payments would be. Field owed debts to others and these debts took priority to Field's debt to the Trust Estate. Second, although the Trust

Estate had defenses to Field's claims in the litigation, it was uncertain whether the Trust Estate would prevail. If Field won, the Trust Estate might have had to pay damages that exceeded Field's debt. Finally, the settlement ensured KS a favorable rate of return on its overall investment, ensured that Field received fair value for his investment, and eliminated Field's claims against the Trust Estate. Aipa concurred in the decision to settle the case, and, therefore, recommended that the Trustees approve the proposed settlement.

Given the amount at stake, the strength of the plaintiff's claims against KS, the evidence, and the uncertainty over how the court would rule on pending motions for summary judgment, the decision to settle was supported by a reasoned analysis. We found no impropriety by Cades with respect to its role in the Field settlement.

C. The Payment of Milton Holt's Legal Fees

1. Hare's September 26, 1994 Letter

In a September 26, 1994 letter to Nathan Aipa, Michael Hare recommended that the Trust Estate pay Milton Holt's legal expenses incurred during the federal government's investigation of Holt. After discussing the wide-spread federal investigation of public corruption, of which the Holt investigation was a part, Hare observed that the political climate in Hawaii was hostile toward KS and its interests. Hare then stated that, because of this hostile attitude towards KS, it was in the Trust Estate's interest to "preserve legislative voices which offer visions other than those belonging to opponents of KSBE . . . . Accordingly, employees of KSBE such as Holt have been permitted to run for and hold public office."

Hare went on to state that because there was a "linkage" between KS's employment of Holt, the federal government's interest in his role as a state senator, and the federal government's investigation of him, it was proper for the Trust Estate to reimburse Holt, as he was not charged with any wrongdoing. Hare relied primarily on the statement of Doug Young, Holt's attorney during the investigation, for the notion that the investigation was based, at least in part, on Holt's employment by KS.

Hare's conclusion seems flawed, however, because no contemporary evidence exists to support the premise that Holt's employment by KS was a reason for the federal government's investigation of him. Hare acknowledged this in his opinion, but nevertheless concluded that reimbursement was proper:

> The legal fees incurred by Holt have a linkage with his employment by KSBE. The investigation may have been conducted even if he had no relationship with KSBE; however, this is not clear and it is evident that his relationship, at the minimum, was a substantial factor in making Mr. Holt a higher profile and more controversial target than if he had not been affiliated with KSBE.

Because the federal government may have investigated Holt regardless of his employment by KS, the only basis for Hare's recommendation would appear to be his statement that Holt's employment by KS was a "substantial factor in making Holt a higher profile and more controversial target." Hare did not, however, offer any more evidence for this statement than he did for the one that the investigation of Holt was linked to Holt's employment with KS. Moreover, even if it is assumed that such statements were true, Hare did not offer any *legal* support for his conclusion that reimbursement was proper.

Hare's letter has been criticized for its non-legal analysis of what should be a legal issue; moreover, it has been alleged that the payment of Holt's legal fees constituted an impermissible private benefit to Holt. Hare did not open a separate matter for this work, did not record his time, and did not bill the Trust Estate for the work done in conjunction with the letter. The letter does not provide a legal analysis of the situation, and does not provide legal support for Hare's conclusion. Hare does not recall if he performed any legal research on the question. Hare based his understanding of the relevant facts on a few phone calls to Nathan Aipa and Doug Young, Holt's personal attorney. Hare asked Doug Young if Young felt that Holt's employment with KS was a reason for the investigation. Young stated that he thought it was. and Hare was satisfied that this provided a basis for reimbursement. Hare did not probe the issue further.

2. Application of Legal Standards

Under the applicable legal standards, it is questionable whether Hare's letter reflects the degree of care, skill, diligence, and knowledge commonly possessed and exercised by a reasonable, careful, and prudent lawyer in the practice of law. Hare did inquire as to whether the investigation was linked to Holt's employment, but it is not clear that he received a conclusive or satisfactory answer. Furthermore, even given such a linkage, Holt cites no legal authority stating that payment is proper. Instead, he analogizes the situation to one in which a corporate director is investigated, but ultimately cleared, for conduct related to his employment. Hare does not, however, provide a legal analysis of whether employees of a trust can be indemnified to the same extent as corporate employees. Nor does he discuss whether payment of Holt's attorney's fees satisfies the test for corporate indemnification.

Despite the lack of legal authority and reasoned analysis, however, the letter does not form the basis for a successful legal malpractice claim. The Trust Estate is likely to have trouble establishing that but for Hare's opinion, payment would not have been made; Aipa appears to have personally endorsed this result. Damages, moreover, are *de minimis,* as the legal fees that KS paid on Holt's behalf are slightly less than $15,000. Given the difficulties of bringing such a case, settlement is unlikely and costs to KS would likely exceed any damages it could hope to recover. Furthermore, Hare did not bill the Trust Estate for work done in conjunction with the September 26, 1994 letter. Consequently, disgorgement of fees is not an available remedy.

D. Work Done with Respect to the Master's Review

The Cades firm was not integrally involved in the Trust Estate's response to the Master's review; rather, the firm performed select tasks when requested to do so. Pursuant to specific requests from Aipa, Cades researched various issues relevant to the Master's review—namely, the scope of a Master's authority and changes in the Probate Rules. In February of 1995, Aipa asked Hare to research the scope of a Master's authority, in response to which Hare prepared a memorandum containing a survey of the law applicable to Masters' proceedings. Also in February of 1995, Aipa asked Hare to research changes to the Probate Rules. The Board of Trustees was entitled to seek legal advice regarding the Master's authority and the Probate Court rules applicable to proceedings before a court-appointed Master. Cades was not obligated to question or second-guess this request for advice. Consequently, the work Cades did here was proper.

At the request of General Counsel, Cades also advised the Trust Estate on possible actions it could take in conjunction with Master Matsumoto's endorsement of Governor Cayetano in a letter that also praised the AG's investigation of the Former Trustees. Cades concluded that, although the Trust Estate is entitled to an impartial Master and might have possible courses of action, KS should be tempered in its response. Cades did not prepare any filings seeking to disqualify Master Matsumoto on this ground (or any other ground). Nor did Cades prepare a memorandum on the issue.

Contrary to Master Richards' suggestion, this work—advising KS on possible actions to take in conjunction with the Master's endorsement of Governor Cayetano—was proper. Master Richards points to this matter as an example of Cades' efforts to assist the Former Trustees in discrediting the Master. *See* Richards Rpt. at 50. The Trust Estate, however, has a legitimate interest in ensuring that Masters deciding KS matters are unbiased. If there is any possibility that a Master or a court is biased against the Trust Estate. KS can, and in certain cases should, look into the matter. It therefore was appropriate for Cades to provide advice on the matter.

Master Richards also questioned the relevance of the limited work the Cades firm did to assist KS in responding to Master Matsumoto. *Id.* at 50-51. On a few occasions, the KS General Counsel's office asked Cades to assist in preparing a response to the Master on various issues that Cades had worked on, such as the Field settlement. LaPorte did most of this work, which consisted primarily of document production on a specific topic. There was nothing improper about Cades assisting the Trust Estate in its responses and productions to the Master. The Trust Estate had a duty to submit such responses and productions, and, accordingly, could hire Cades to help the Legal Group carry out this duty.

E. Research into Judge King's Statements

In 1997, Judge King, a sitting federal judge, assisted in writing the *Broken Trust* article, which helped precipitate the AG's investigation of KS. Judge King also criticized the KS Trustees during a number of public speeches. At the time, KS was involved in a number of litigation matters, both in federal and state court, and was concerned that Judge King's comments could influence the judges before whom KS's cases were pending. Aipa and Trustee Jervis asked Cades to look into whether there are constraints on what sitting judges may say publicly. As a result, Cades conducted the research and produced a memorandum.

The memorandum was, for the most part, a survey of the law applicable to sitting federal judges. Based on the applicable law, the memorandum concluded that Judge King's comments likely violated the Code of Conduct for United States Judges. Nevertheless, the memorandum found that there was no remedy for such a violation. Hare therefore recommended that no action be taken.

Master Richards questioned this research, stating that it was "chilling and wholly inappropriate work," and was an attempt to "silence or at least discredit [KS's] critics." Richards Rpt. at 59. This criticism seems unfounded in light of the memorandum's content and conclusions. The Trust Estate has a right to unbiased judges, and, therefore, was justified in exploring ways to protect that right. The Trust Estate, acting through its Trustees and General Counsel, also had the right to seek legal advice on the issue; therefore, it was proper for Cades to render such advice. Furthermore, the memorandum did not reach any inappropriate conclusions. The memorandum did not suggest that the Trust Estate bring an action against Judge King, or pursue the matter in any other fashion. Instead, the memorandum concluded that, although there was a violation, there was no remedy for KS to pursue.

F. Work on the Harmon Matter

The Cades firm did not perform any work for KS in conjunction with the Trust Estate's settlement negotiations with Bobby Harmon, a former KS employee. After the settlement, however, the Trust Estate received information indicating that Harmon had breached the confidentiality provision of the settlement agreement, as well as a court-imposed injunction preventing Harmon from disclosing Trust Estate information. In September of 1997, KS asked the Cades firm to research the potential remedies for Harmon's disclosure of confidential KS information. Dennis Chong Kee worked on the matter and wrote three memoranda for Aipa.

Chong Kee researched who was bound by the injunction and what remedies KS had for violations of the injunction. Chong Kee concluded that the AG and other third persons were bound by the injunction if they had notice of it and acted in concert with Harmon. The remedy, Chong Kee concluded, was a return of the documents. Chong Kee also researched whether the journalistic privilege would prevent KS from obtaining or reviewing the documents in the newspaper's possession. KS wanted to see these documents to determine who leaked them to the press—each set of documents prepared by the Trust Estate had a different watermark. Chong Kee concluded that the newspaper likely could successfully assert the privilege, thereby preventing KS from determining the source of the leak.

Based on a review of the Cades billing records, Master Richards concluded that this work was inappropriate and should not have been billed to KS. Richards Rpt. at 59. Master Richards determined that this work was for the benefit of individual Trustees, who hoped to silence their critics, but in no way benefited the Trust Estate. *Id.* Contrary to this criticism, it is our assessment that this work did in fact benefit the Trust Estate, and was performed pursuant to specific direction from KS. KS clearly had an interest in ensuring that confidential Trust Estate documents were not leaked to the press. Cades' work in providing advice on this issue therefore was proper.

G. Hare's Role in Advising KS's General Counsel After August 1997

After the AG's investigation began in August 1997, Aipa requested that Hare provide legal advice to the Trust Estate on how to respond to the investigation. Aipa also asked Hare to participate—along with Bruce Graham and Wayne Pitluck—in weekly Monday morning meetings during the AG's investigation. The purpose of these meetings was for Aipa to gain perspective and advice on various issues facing KS, and to assist him in his role as General Counsel. We found that this group of Aipa, Hare, Graham, and Pitluck provided advice to KS as an entity, and had the Trust Estate's best interests in mind.

Master Richards called Hare "a critical figure in policy formulation and implementation," who acted on KS's behalf, without being counsel of record. Richards Rpt. at 56. Master Richards states that this leads to the "clear impression" that Michael Hare acted as "shadow lead counsel." *Id.* The evidence does not support this assertion. Indeed, there is no evidence that Hare was regarded as such by his peers, including William McCorriston, who served as lead counsel for the Trust Estate during the AG's investigation. Instead, Hare was one of many attorneys whom Aipa consulted for legal advice. Cades was retained by the General Counsel's office, and such retention was proper. Cades was under no obligation to question this retention. Any duplication of efforts, moreover was due to Aipa's insistence on having multiple sounding boards, which was not unreasonable on Aipa's part. In circumstances of intense legal activity of the sort in which KS was engaged in the fall of 1997, it is particularly desirable for a decisionmaker to have multiple sources of expertise and judgment. It was sensible of Aipa to perceive a need for this early on and it was appropriate for the law firms, including Cades, to assist Aipa in this manner.

H. Cades' Role in Responding to the AG's Investigation

In assembling a team to respond to the AG's investigation, Aipa directed each of several law firms to perform specific tasks. KS chose Cades to be in charge of document production because of the firm's institutional knowledge of some of the issues involved, its knowledge of many of the documents, which Cades reviewed previously in other litigation, and its established working relationship with the KS staff. The Trust Estate had an obligation to comply with the subpoenas, but did not have the capacity to handle the requests internally. KS therefore asked Cades to assist in discharging this obligation.[26]

Cades' knowledge and its existing relationship with KS staff were vital to the Trust Estate's compliance with the AG's subpoenas, which called for copious documents to be

[26] We found no support for Master Richards' criticisms of Cades' document production work. Richards Rpt. at 56. As to his allegation that Cades improperly reviewed photographs of KS students protesting actions of the Former Trustees, *id.* at 61, Cades reviewed these photographs solely for production to the AG and in response to a subpoena requesting the photographs. Furthermore, there is no evidence that Cades withheld documents on matters in which Cades advised the Trust Estate. Cades' prior involvement in these matters therefore does not call into question the firm's screening of these documents in response to the AG's subpoenas.

reviewed and produced on short notice. Indeed, Colleen Wong, now KS General Counsel, and Darolyn Lendio, of the McCorriston firm, both acknowledged that, without the enormous amount of work that Cades did, it is unlikely that the Trust Estate could have complied with the AG's subpoenas in a timely fashion. It is our assessment that without Cades' participation, many more attorneys and paralegals would have been needed, and many more hours would have been spent to comply with the AG's requests. Moreover, Cades' performance of the document production work appears to have resulted in minimal duplication. In general, others did not review the documents or privilege determinations that Cades made; rather, there was a demarcation of responsibility, which was closely followed.

Moreover, we found that KS's need for assistance with document production was in part owing to the AG's refusal to accept KS's proposal for protecting the Trust Estate's privileged and confidential documents. Because the AG would not agree to a protective order for privileged documents, KS had to review every document for privilege, withhold those that were privileged, and maintain an accurate and detailed privilege log. LaPorte did most of this work and made the majority of the privilege determinations.

KS took a reasoned and principled position on protecting the Trust Estate's attorney-client privilege with regard to the AG's investigation. Indeed, the Probate Court ultimately upheld almost all of the privilege determinations Cades made during the AG's investigation. Cades did not engage in any obstructionistic tactics.

I. Materials Requested by Individual Trustees

Cades never represented the Trustees individually, and never did work that was not authorized by Aipa or the Board of Trustees. Hare and others at the Cades firm did, at times, have contact with individual Trustees, but this was in the normal course of their representation of KS. Trustee Jervis (the lead Trustee for legal matters), for example, often would call Hare to inquire about various legal issues. But neither Hare nor the Cades firm did work solely at the request of Trustee Jervis, or of any other individual Trustee. Aipa or the Board of Trustees always approved the use of Cades before any work was undertaken.

At times, upon direction of the General Counsel's office, Cades assisted KS in responding to document requests by individual Trustees. Because each individual Trustee had a right to see Trust Estate documents, KS had a duty to make those documents available. KS did not have the internal capacity to handle such document requests, and therefore asked Cades to do this work. When Cades personnel performed this work, those handling the requests would note in their time entries that they were collecting documents for individual Trustees. KS asked that this be done so that the Trust Estate could bill the individual Trustees for the work. It was KS's obligation, not Cades', to ensure that the individual Trustees paid these expenses where appropriate. We found no evidence during our review that Cades was protecting the interests of the majority Trustees, or of any individual Trustee for that matter. Cades never performed work upon request of an individual Trustee, but instead did work only at the request of either the General Counsel's office or the Board of Trustees as a whole.

J. Miscellaneous Category

1. Change in Domicile

Hare provided Aipa with a legal opinion on the change in domicile issue on November 8, 1996. This work was performed at Aipa's request. Aipa told Hare that Trustee Jervis wanted to explore the possibility of a change in domicile or tax status. In our interview of Hare, he stated that it was common for Trustee Jervis to want to explore new ideas. Hare's memo concluded that the Trust Estate could not change its domicile or tax status. Hare stated that he did not know, at the time he performed this work, that Verner Liipfert had investigated the same issue. Cades was entitled to assume that, and was not bound to inquire whether, the Former Trustees had the power to make such an investigation. The Trustees were entitled to seek such legal advice and Cades was, by the same token, entitled to provide such advice without second-guessing the request. Furthermore, we found no evidence indicating that Cades had actual knowledge, or even any reason to know, that the Former Trustees' investigation into a change in the Trust Estate's domicile and tax status exceeded, or was an improper exercise of, their powers. Moreover, Cades came to the proper conclusion that no such action could be taken.

2. Grand Jury Investigations

Cades did not do any substantive work in conjunction with the Grand Jury subpoenas. Instead, LaPorte and others at the Cades firm helped respond to the Grand Jury subpoenas in the same capacity and manner in which the firm helped respond to the AG's subpoenas. As with the AG's investigation, the Grand Jury subpoenas were directed to KS and called for Trust Estate records. The Trust Estate therefore had a duty to respond. Because KS did not have the internal capacity to handle these requests, the Trust Estate again asked Cades to assist in document review and production. Cades assisted KS in discharging a Trust Estate duty; the work that Cades did here was proper.

3. Work Done in Conjunction with the IRS Audit

KS's General Counsel requested Cades' assistance in working on a few discrete areas of the IRS Audit. First, Cades assisted on occasion in responding to the IDRs. This work consisted primarily of document production duties similar to what Cades was doing for the AG investigation. Second, Cades was involved in responding to the request for technical advice on the effect of KS's admissions policy on the Trust Estate's tax-exempt status, which the IRS decided in KS's favor. Finally, Cades was involved in researching the attorney-client privilege with respect to the IDRs, which led to the firm's additional involvement in assisting KS with responses to various issues raised in the Forms 5701. The work that Cades did here was in the

Trust Estate's best interests, was properly authorized, and we found no evidence that its work was wrongful or improper.

III. APPLICATION OF LEGAL STANDARDS

A. No Basis for a Professional Liability Claim

There is no basis for a professional liability claim against the Cades firm. In all cases, the work that Cades did was authorized either by the General Counsel's office or the Board of Trustees acting as a collective body. In none of these instances was Cades required to second-guess the Trust Estate's request for legal advice. *See* Leubsdorf at 7-8. Nor were there circumstances in which Cades' attorneys were in a position that obligated them to disclose conduct of the Trustees to the Probate Court or another third party. There were no instances in which members of the Cades firm had actual knowledge of illegal conduct by Trustees.

Michael Hare's memorandum on the payment of Milton Holt's legal fees is the only work by a member of the Cades firm that raises any issues. As stated above, it is not clear whether Hare's memorandum demonstrates the necessary degree of care, skill, and diligence that other attorneys would exercise in similar circumstances. At the same time, however, Hare's memorandum does not give rise to a viable cause of action.

B. No Basis for Disgorgement

Nor are there instances in which disgorgement of fees is appropriate with respect to Cades. Cades did not bill for any work that was manifestly inappropriate. Nor did a situation exist in which Cades was obligated to inform the Trust Estate that the work requested should not be rendered. Finally, there were no instances in which Cades purported to represent KS, and was in fact paid by the Trust Estate, but actually represented divergent interests of individual Trustees.

C. Recommendations for Future Use

The decision whether KS should continue using the Cades firm in the future for legal services is one that falls within the Trustees' sound discretion. In exercising that discretion, the Trustees should consider all of the circumstances noted herein, including the commendable work that the Cades firm has provided to the Trust Estate for decades. We found no reason that would prevent KS from retaining the Cades firm in the future.

SECTION THREE - PROVIDER-SPECIFIC ANALYSIS FOR McCORRISTON MILLER MUKAI MacKINNON

I. INTRODUCTION

In performing our review of the McCorriston firm, we interviewed William McCorriston, Darolyn Lendio, Scott MacKinnon, and Stan Mukai. All are partners at the McCorriston firm. In all, we conducted approximately 20 hours of interviews. We also reviewed approximately 45 boxes of documents from the McCorriston firm's files as well as from KS files related to McCorriston. These documents and interviews formed the basis for our findings contained herein.

William McCorriston was hired specifically to represent the Trust Estate during the AG's investigation. This was the first time that William McCorriston did work for the Trust Estate. Another partner at the McCorriston firm, Scott MacKinnon, had worked on real estate matters for KS since the 1980's. Until McCorriston's involvement in the AG's investigation, MacKinnon's work represented the McCorriston firm's sole involvement in KS matters.

Our analysis of the McCorriston firm focuses on William McCorriston's representation of the Trust Estate during the AG's investigation. More specifically, we focus on whether McCorriston represented KS's interests, or those of the individual Trustees, and whether McCorriston engaged in tactics designed to obstruct the AG's investigation. Our analysis also examines the internal factual investigations that the McCorriston firm performed at KS's request, as well as various matters in which the McCorriston firm played only a small role.

II. ISSUE-SPECIFIC DISCUSSION

Master Richards made the following assertions, which are the two main allegations raised against the McCorriston firm: (1) the McCorriston firm represented the individual Trustees' interests and not the interests of KS, such that its efforts constituted "a defense of the trustees, not of the trust," Richards Rpt. at 67; and (2) the McCorriston firm carried out a strategy adopted by the Board of Trustees (acting in their individual interests only) "to obstruct the legal process, to delay where ever [*sic*] possible, to object where ever [*sic*] possible, to utilize so many lawyers and so many arguments that the opposition would be overwhelmed and would choose to give up." *Id.* at 11. Notwithstanding these assertions, Master Richards ultimately recommended that a refund from the McCorriston firm not be pursued. *Id.* at 75. Master Richards also stated that the McCorriston firm "was vigorously defending as lead counsel of record. It was not trying to hide its own past conduct and was not functioning 'in the shadows.' It appears to have been acting upon directions of the trustees, who were knowing and purposeful people." *Id.* We agree with Master Richards' ultimate conclusion; however, we believe his specific criticisms of the McCorriston firm's representation of KS are based on an inadequate review of the facts. Consequently, we discuss below our understanding of the facts, and our conclusions with respect to them.

A. McCorriston Miller Mukai MacKinnon's Representation of KS, as Opposed to Individual Trustees

Master Richards asserted that the McCorriston firm's representation of KS during the AG's investigation served the interests of individual Trustees only, and not those of the Trust Estate. We examined six areas that involved a potential or actual divergence of interests between the Trust Estate and the individual Trustees; we consider the McCorriston firm's involvement in each of these areas below. First, we discuss the McCorriston firm's initial representation of KS.

Second, we consider the McCorriston firm's general approach to, and involvement in, the AG's investigation. Third, we discuss McCorriston's analysis of the difference between Trust Estate issues and individual Trustee issues. Fourth, we consider the firm's interaction with individual Trustees. Fifth, we discuss other specific matters the McCorriston firm worked on during the AG's investigation. Finally, we consider Stan Mukai's simultaneous representation of Trustee Wong during the AG's investigation.

1. Scope of the McCorriston Miller Mukai MacKinnon's Initial Representation of KS

By a unanimous vote of the Board of Trustees, KS retained William McCorriston and the McCorriston firm on September 23, 1997. KS General Counsel Nathan Aipa sent a retention letter to William McCorriston on that same day. The retention letter stated that the McCorriston firm was to handle all litigation matters arising out of the AG's investigation. The McCorriston firm was not charged with handling matters of trust law.

From the beginning of the McCorriston firm's retention, Aipa informed William McCorriston that he was to represent the interests of the Trust Estate, not the interests of individual Trustees. Indeed, in the September 23, 1997 letter retaining McCorriston as lead litigation counsel, Aipa stated that neither McCorriston nor anyone from the McCorriston firm was to represent the Trustees individually. Aipa also informed the Former Trustees of this, stating that the attorneys retained by KS represented the Trust Estate only, and not the interests of individual Trustees.

In a letter dated September 24, 1997, Aipa notified Bruce Graham and Michael Hare that KS had retained McCorriston as lead litigation counsel. Aipa also informed Graham and Hare that McCorriston would be assisting in the Master's review. A chart setting forth the responsibilities of KS's respective outside attorneys was attached to the letter. According to the chart, the McCorriston firm was to act as KS's advisor on litigation and trial matters, lead litigation counsel for the AG's investigation, and KS's media voice.

At times during its representation of KS, the McCorriston firm took assignments from the Board of Trustees based on a three-to-two vote. Such direction, however, was no less binding than a unanimous vote of the Board. Indeed, the Will provides that a vote of a majority—three Trustees—binds the Trust Estate and constitutes an official action by the Board. It was therefore proper for the McCorriston firm to act upon a vote of three Trustees, and to take directions from such a majority. Master Richards' criticism of McCorriston for "reliance upon the so-called 'enterprise' theory of representation" is therefore misplaced. Richards Rpt. at 67.

2. McCorriston Miller Mukai MacKinnon's General Involvement in and Approach to the AG's Investigation

The McCorriston firm took an active role in responding to the AG's investigation. The work included, among other things, responding to specific document subpoenas, filing necessary objections to those subpoenas, filing responsive pleadings in law suits generated as a result of the AG's investigation, and conducting a limited number of internal investigations into the facts. We found no evidence that the McCorriston firm exceeded the scope of its representation. More important, contrary to Master Richards' allegation that the McCorriston firm defended the Trustees, not the Trust Estate, *id.,* we found that, in each of its endeavors, the McCorriston firm represented identifiable Trust Estate interests, as opposed to interests of individual Trustees.

The McCorriston firm sought to protect KS's attorney-client privilege and KS's confidential business information. All legal advice given to the Trust Estate was protected by the attorney-client privilege, and the privilege could be waived only by a majority vote of the Board of Trustees. The Board of Trustees instructed the McCorriston firm to protect the attorney-client privilege, which was a reasonable and appropriate directive. If KS had waived its privilege, private litigants bringing actions against the Trust Estate would be able to obtain privileged documents for use in such litigation. Moreover, a lawyer ordinarily has a duty to assert the attorney-client privilege with respect to all client-related communications.

The Trust Estate also instructed its outside counsel, including the McCorriston firm, to protect the confidential business information of the Trust Estate and its subsidiaries. These documents contained sensitive proprietary information; public release of such information could have adversely affected KS in its business and financial dealings. It was reasonable and appropriate for KS to protect its confidential business information. The Board of Trustees had the right and duty to retain counsel to respond to the AG's investigation and protect KS's important interests. This is consistent with the opinions of Professors Langbein and Leubsdorf. We disagree with Master Richards to the extent he suggests otherwise. Richards Rpt. at 65-66.

3. McCorriston's Analysis of Trust Estate Versus Individual Trustee Issues

Shortly after the AG filed her petition seeking to surcharge the Former Trustees for various alleged breaches of their fiduciary duties, McCorriston analyzed the issues raised therein to determine which issues constituted Trust Estate issues and which issues were personal to the Trustees. McCorriston determined that he could not address issues that were personal to the Trustees or that were mixed personal/KS issues. After conducting his analysis, McCorriston determined that there were too many personal issues, and too many issues in the gray area of mixed personal and Trust Estate issues, for him to get involved. At this point, he notified Aipa that, because he was not a trust lawyer, McCorriston could not respond to the various allegations in the AG's surcharge petition. Accordingly, personal counsel for the individual Trustees responded to these issues.

McCorriston's role in the AG's investigation from this point forward was limited to responding to, and challenging when necessary, the AG's subpoenas. McCorriston also represented the Trust Estate in matters related to protecting KS's privileged and confidential documents.

4. Interaction with Individual Trustees

On November 5, 1997, Aipa sent a memorandum instructing KS's outside counsel not to communicate with the individual Trustees. McCorriston objected to this letter, stating that he needed authority to talk directly to the Trustees and KS employees. McCorriston feared that he would not be able to perform his responsibilities adequately without talking to the Trustees individually. Following McCorriston's objection, Aipa no longer insisted that McCorriston follow the instructions contained in Aipa's November 5, 1997 memorandum.

Time records indicate that attorneys from the McCorriston firm would, from time to time, deal directly with an individual Trustee, or with counsel to an individual Trustee. McCorriston would, for example, talk to an individual Trustee when dealing with a matter within that Trustee's bailiwick under the lead trustee system. On occasion, he would answer questions from individual Trustees and provide them with copies of work that he had done for the Trust Estate. We found no evidence that the McCorriston firm performed this work for certain Trustees to the exclusion of others. Nor did we find any evidence that, in doing this work, the McCorriston firm represented the interests of individual Trustees rather than the Trust Estate. The McCorriston firm answered questions and provided documents upon direction of the General Counsel. The Trustees had a right to see KS documents, and the McCorriston firm was discharging a Trust Estate duty by making these documents available to the Trustees.

5. Other Specific Representations

In addition to KS's initial retention of the McCorriston firm as litigation counsel for the AG's investigation, KS also retained the McCorriston firm to represent the Trust Estate in other matters.

a. *Burgert* and *Mederios* Class Actions

KS requested that the McCorriston firm defend KS in the *Burgert* and *Mederios* class action cases filed in federal court. The plaintiffs in those cases sued both KS and the individual Trustees. The McCorriston firm filed a motion to dismiss on behalf of KS and the individual Trustees, seeking a dismissal on jurisdictional grounds. The court dismissed both cases and the Ninth Circuit affirmed.

The McCorriston firm's representation of the individual Trustees in the *Burgert* and *Mederios* class action complaints led to allegations that the McCorriston firm represented the Trustees in their individual capacities. The McCorriston firm denied that it ever represented the Trustees in their individual capacities, except to the extent that the Trustees' interests coincided with KS's interest in having the class action lawsuits dismissed. The McCorriston firm's limited representation of the individual Trustees in the *Burgert* and *Mederios* cases does not imply that the firm represented the individual Trustees' interests in the AG's investigation.

b. Campaign Spending Commission Matter

On September 25, 1998, the Hawaii Campaign Spending Commission ("CSC") filed a complaint against KS and several of KS's employees. The complaint alleged that KS and several of its employees made excessive contributions to Milton Holt's campaign fund. KS retained the McCorriston firm to represent the Trust Estate in the CSC matter. McCorriston worked closely with Nathan Aipa in determining what steps to take in the litigation. The Trust Estate did not file an answer to the CSC complaint. Instead, the McCorriston firm filed a lawsuit on KS's behalf, alleging that the complaint against KS was deficient and should have been dismissed; KS argued that it was not a proper party to the lawsuit because it was a corporation and not an individual. This reasoning ultimately prevailed. The McCorriston firm's representation was authorized and protected the Trust Estate's interests.

c. McCorriston Miller Mukai MacKinnon's Work in Connection with the Master's Review

KS's General Counsel directed the McCorriston firm to perform some work in connection with the Master's review. In particular, MacKinnon helped prepare responses to the Master on the Kalele Kai and Hamakua transactions. MacKinnon dealt directly with Aipa on this matter. MacKinnon came to be involved with the Kalele Kai investigation because he had worked on the underlying real-estate transaction and thus was familiar with it. MacKinnon did not, however, work on the underlying Hamakua transaction. This work assisted the Trust Estate in discharging KS's obligation to respond to the Master.

KS also asked McCorriston to assist Graham in developing a strategy for responding to the Master. The McCorriston firm helped by preparing affidavits to submit on the accumulated income issue. It was not unreasonable for the McCorriston firm to assist Ashford & Wriston in this regard. Again, this work helped the Trust Estate to discharge its obligations to the Master and the court.

d. November 17, 1998 Board Resolutions

On November 17, 1998, the Board of Trustees, by a majority vote, passed three resolutions that specifically directed the McCorriston firm to perform additional legal work for the Trust Estate. The first of these three resolutions directed Ashford & Wriston and the McCorriston firm to prepare a joint opinion on the Trustees' discretionary powers, the role of the Probate Court, Master, and AG in reviewing such discretion, and the applicable standard of review. The second of these three resolutions directed the two firms to prepare an opinion on whether the Trust Estate was required to expend all of its income on educational purposes within a certain time period, and whether KS's accounting and reporting of income for the 109th, 110th, and 111th annual accounts complied with the terms of the Will and applicable law. The last of these resolutions required the two firms to point out to the Trustees inaccuracies, mischaracterizations, erroneous conclusions, and unjustified criticisms contained in the Master's Report.

Master Richards alleged that the work the McCorriston firm did pursuant to these resolutions furthered the interests of the individual Trustees, rather than those of the Trust Estate. Richards Rpt. at 64. The Board of Trustees authorized any work that the McCorriston firm did in conjunction with the above resolutions. Although the legal fees incurred here might be surchargeable to the Trustees who authorized the resolutions, we found no evidence that the McCorriston firm acted illegally, unethically, or in bad faith by following the directives of a majority of the Board of Trustees.

6. Stan Mukai's Representation of Trustee Wong

Stan Mukai, a partner at the McCorriston firm, has represented Trustee Wong personally for approximately 25 years. This representation consists primarily of estate- and tax- planning matters. Mukai continued to represent Trustee Wong personally during the AG's investigation, while William McCorriston represented the Trust Estate.

Mukai and Trustee Wong also have a long-standing friendship. In addition to performing legal work for Trustee Wong on personal matters, Mukai would often provide general advice to Trustee Wong. Mukai stated that, over breakfast meetings, he might have discussed with Trustee Wong various KS matters, but considered this to be a discussion between friends and not legal advice. Mukai apparently did not bill for these meetings. Indeed, Mukai did not have any entries on the McCorriston firm's bills to the Trust Estate. Furthermore, in a letter to Morgan Lewis dated October 2, 2000, McCorriston confirmed that Mukai did not bill Trustee Wong for advice relating to the AG's investigation or other KS matters.

The McCorriston firm's billing records for KS matters indicate that, on five separate occasions, McCorriston, Lendio, and MacKinnon all billed for time spent consulting with Mukai on KS matters. Together, these consultations account for only 2.25 hours of time. McCorriston, Lendio, MacKinnon, and Mukai all stated that these conversations related to background information on Trustee Wong, which was necessary and helpful in McCorriston's representation of the Trust Estate.

The potential for a conflict between Trustee Wong's individual interests and KS's interests on certain matters raises a question about the propriety of the McCorriston firm representing simultaneously the Trust Estate as an institution and Trustee Wong personally, even on unrelated matters. Although this may have given rise to an appearance of a conflict, we did not find evidence of an actual conflict. Because Trustee Wong consistently voted in the majority, it is unlikely that Mukai gave any "advice" to Wong relating to Trust Estate matters that actually conflicted with or was adverse to KS's interests (as defined by the majority).

The sole remaining issue here is whether Mukai's representation of Trustee Wong on personal matters created an appearance of a conflict that should have been avoided. There is no doubt that this simultaneous representation raised the appearance of a conflict. The concern is that the McCorriston firm's advice to KS regarding what was in the best interest of Trust Estate was colored by the firm's simultaneous obligation to further Trustee Wong's personal interests. We found no evidence that such advocacy occurred. Nor does the failure to avoid an appearance of a conflict of interest violate the Rules of Professional Conduct.

B. Litigation in Response to the AG's Investigation

The AG's investigation generated approximately 200 subpoenas and created a number of novel legal issues. Master Richards criticized the McCorriston firm for its response to the investigation. Richards Rpt. at 71. It is our assessment that the positions KS took were reasonable. Moreover, the Trust Estate's positions were upheld in large part by the Probate Court. Below, we analyze the litigation tactics employed by the McCorriston firm and place those tactics in the context of KS's dispute with the AG over the investigation. As our discussion indicates, the McCorriston firm consistently represented KS's interests without overstepping the bounds of an attorney's charge under the Professional Rules of Conduct to diligently and zealously represent his or her client. HRPC 1.3 and cmt. 1.

1. KS's Response to the AG's Investigation

The initial contact between the Trust Estate and the AG's office in August of 1997 occurred before KS retained the McCorriston firm. Bruce Graham represented KS during these initial communications with the AG. The correspondence between Graham and the AG demonstrates that KS was willing to cooperate with the AG's information requests, but wanted to ensure that privileged documents given to the AG would be protected from disclosure. The AG refused to enter into a protective agreement, however, stating that she did not want to be bound by restrictions on disclosure. The Trust Estate therefore requested that the Probate Court issue a protective order.

Graham filed a Petition for a Protective Order on September 11, 1997. The Memorandum in support of that Petition, filed before KS retained the McCorriston firm, clearly states KS's position:

> [T]he Trustees seek a protective order to prevent public disclosure of the Trust Estate's internal records, including confidential business and proprietary information, disclosure of which could lead to loss or disadvantage to the Trust

> Estate when such information is produced in connection with an investigation commenced by the Attorney General.
>
> The Petition is not intended to hinder, impede, delay or otherwise frustrate the Attorney General's investigation. Indeed, the Trust Estate's records, including documents responsive to Subpoena No. 97-71, are now and have been available to the Attorney General, subject only to the provisions of the Guidelines established by stipulation of the Attorney General and Order of this Court . . . .

After filing this Petition, counsel for the Trust Estate continued to attempt to reach an agreement with the AG. The documentary evidence demonstrates that the AG and her staff continued to reject these attempts to reach a reasonable solution.

Soon after KS retained the McCorriston firm, McCorriston continued Graham's efforts to reach an agreement with the AG's staff. McCorriston sought to implement a procedure whereby KS could produce all relevant documents to the AG without waiving the attorney-client privilege and without permitting the AG to make confidential information available to the public. McCorriston also proposed a procedure under which the AG could seek approval to make public certain information when necessary. We conclude that McCorriston's actions in seeking to protect privileged and confidential information were appropriate.

KS authorized the McCorriston firm's efforts to protect KS's privileged and confidential business information. KS's position was inherently reasonable. Indeed, the Probate Court ultimately entered the protective order that KS sought. The protective order preserved the attorney-client privilege and protected the confidentiality of KS documents. The Trust Estate would not have sought such an order from the court, however, if the AG had agreed to a protective order in the first instance.

2. Motions for Protective Orders

The McCorriston firm, acting with KS's authorization, challenged only ten of approximately 200 subpoenas the AG issued to KS during the AG's investigation. This belies

Master Richards' allegation that "[t]here were monumental efforts made to keep trustee conduct from coming to light" and that the Trustees adopted "a strategy of obstruction and delay." Richards Rpt. at 67. Having evaluated them in their proper context, we conclude that Master Richards' criticisms are again misplaced.

The first subpoena with respect to which the McCorriston firm moved for a protective order sought Trustee minutes. The challenge sought to protect the Trust Estate's attorney-client privilege and its confidential proprietary information. Although the Probate Court rejected some of McCorriston's other challenges to the subpoena, Judge Chang did issue a protective order covering "all proprietary confidential information and also attorney-client privilege[d] and attorney work product privilege[d] information of KSBE." McCorriston's challenge of the subpoena therefore resulted in direct benefits to KS.[27]

McCorriston also sought a protective order in response to the AG's subpoena of KSS's admissions records. The subpoenas requested personal information about applicants to the School—both those accepted for admission and those who were denied admission. We cannot agree with Master Richards that this subpoena requested "innocuous information." Richards Rpt. at 72. Instead, the subpoena requested highly personal and confidential information that the Trust Estate had an interest in keeping private, including financial information of applicants for admission and their families. The Trustees reviewed the issues and authorized McCorriston to challenge the subpoena. After the Probate Court ordered KS to produce these files, the McCorriston firm handled the production. Out of the entire production, the AG looked at only eight admissions files.

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[27] Master Richards criticizes much of the research that went into this motion, stating that such research was "looking unsuccessfully for a way to thwart any investigation." Richards Rpt. at 68. Such research, however, was consistent both with the scope of representation and with KS's interests, as discussed above.

A third controversial subpoena issued by the AG called for the Trust Estate to produce the IDRs the IRS issued to the Trust Estate. KS objected to this request, because of the sensitive nature of the information being sought and authorized the McCorriston firm to challenge this subpoena. Judge Chang ordered KS to produce the IDRs, but issued a protective order covering confidential and privileged information. The McCorriston firm also challenged subpoenas seeking Trustee Lindsey's notes and the McCorriston firm's invoices. These challenges sought to protect KS's interests in maintaining the attorney-client privilege and preventing the disclosure of confidential or proprietary information.

We did not find that the McCorriston firm engaged in any obstructionistic or dilatory tactics in responding to the AG. McCorriston objected to only ten of the 200 subpoenas issued to the Trust Estate. All of these objections had a proper foundation, and indeed, the Probate Court sided with KS on many of these challenges. Even where KS did not prevail with respect to all of the arguments asserted, the court often entered a protective order. Finally, KS complied in a timely and complete manner with the AG's numerous subpoenas.

3. Document Production During the AG's Investigation

As discussed in our provider-specific analysis of the Cades firm, *supra,* the Trust Estate gave Cades primary responsibility for document production during the AG's investigation. To the limited extent that the McCorriston firm was involved in document production, Darolyn Lendio did this work. Lendio attended weekly Wednesday meetings to discuss document production issues and the Trust Estate's responses to the AG's subpoenas. In general, when the McCorriston firm received documents from the Cades firm, it merely forwarded them to the AG; the McCorriston firm did not conduct an independent review. Cades also conducted the privilege review.[28] Although there may have been some minor duplication and inefficiency, the efficiencies of the document production process far outweighed those modest inefficiencies.

In limited instances, such as the admissions records, for example, the McCorriston firm undertook the responsibility for the complete document production, including the privilege review. McCorriston also reviewed Verner Liipfert documents at their Washington D.C. office. The McCorriston firm made no representations as to the completeness of Verner Liipfert's document production, but helped ensure that Verner Liipfert documents were produced in response to an AG subpoena. Thus, contrary to Master Richards' assertion that the McCorriston firm sought to prevent the Verner Liipfert documents from being produced, *see* Richards Rpt. at 72, the McCorriston firm helped make them available.

In sum, the McCorriston firm's work on document production was neither duplicative nor obstructionistic. Master Richards' laundry list of documents reviewed by the McCorriston firm simply does not support the allegation that the McCorriston firm in any way tried to prevent the production of those documents. Richards Rpt. at 72. Indeed, in some cases, the McCorriston firm intervened to ensure complete production (*e.g.*, the Holt records and Trustee Lindsey's personal notes).

4. Additional Work Performed with Respect to AG's Investigation

In addition to responding to subpoenas, the McCorriston firm filed a number of motions related to the AG's investigation. The Trust Estate authorized each of the motions that the McCorriston firm filed.

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[28] To the extent that the McCorriston firm conducted an additional privilege review, it does not appear to have been extensive. Given the circumstances of the AG's investigation, we do not believe that an additional privilege review was unwise or inappropriate.

a. Opposition to a Temporary Restraining Order

In October of 1997, the AG moved for a Temporary Restraining Order, alleging that the Trust Estate was destroying documents. The McCorriston firm filed an opposition to the TRO on very short notice, as an emergency measure. The Trust Estate opposed the TRO because there had not been any improper destruction of documents. Aipa was responsible for obtaining Trustee approval to file the opposition. He tried to contact all five Trustees, but was able to reach only three. Once three Trustees approved the response, the McCorriston firm filed KS's opposition to the TRO. Moreover, even though the Trust Estate opposed that TRO, Aipa voluntarily adopted and published a document-retention policy mandating that all Trustees and KS employees retain all Trust Estate records. This policy was put in place well before October of 1997. After the AG moved for the TRO, Aipa sent a letter to the Trustees and KS employees reminding them of this policy.

b. Petition to Prevent the AG from Contacting KS Employees

On May 28, 1998, the McCorriston firm, at Colleen Wong's request, filed a petition to prevent the AG from contacting KS employees directly. The KS employees were represented by counsel, thus making the AG's contact with them improper. Judge Chang ruled that this was in fact improper, and ordered the AG to cease communicating with KS employees directly.

c. Disclosure of Milton Holt Credit Card Information

The McCorriston firm also filed a motion for sanctions against the AG's office for disclosing information related to Milton Holt's allegedly improper use of his KS credit card. Aipa authorized this motion because the Trustees believed the AG was the source of the leak. Aipa secured affidavits from KS personnel confirming that the leaks did not come from anyone at KS. The court ordered the AG to investigate the matter and to submit affidavits stating that the AG's office was not the source of the leak. The AG did so, and the court denied KS's motion based on the AG's affidavits.

d. Disclosure of the WASC Report

The McCorriston firm filed a motion for the return of personal property in an attempt to identify the source of the WASC report that was leaked to the press. The Trust Estate wanted to view the document that the newspaper had in its possession so that it could to identify the document's watermark, and thus the source of the leak. The Board of Trustees specifically requested that the McCorriston firm take this action. The McCorriston firm's vigorous pursuit of the source of the leak does not render its representation improper.

e. Draft Pleadings and Research

Master Richards criticized research and drafting projects that the McCorriston firm undertook on topics such as whether the AG had a conflict of interest, the effect of the appointment of an administrator *ad litem*, and issues of potential bias on the part of Judges Chang and King and Master Matsumoto. *See, e.g.*, Richards Rpt. at 67-74. As discussed below, however, these projects were undertaken at KS's request and the McCorriston firm was entitled to assume that the request was made pursuant to a proper exercise of the Trustees' powers. *See* Langbein at 4-7; Leubsdorf at 7-9.

(1) AG Conflict of Interest

The McCorriston firm researched and drafted a petition to disqualify the AG on grounds that the AG had a conflict of interest. The AG had a potential conflict because she was conducting the investigation of KS as *parens patriae*, while at the same time suing KS in a number of other civil matters, such as condemnation proceedings. McCorriston sent the draft petition to Aipa and the Trustees on April 9, 1998. KS authorized this work, but ultimately chose not to file the petition. On September 8, 1998, Trustee Peters filed a petition similar to the one drafted by the McCorriston firm. McCorriston stated that he did not work with Trustee Peters or his attorneys on this. There is no evidence that indicates otherwise.

(2) Administrator *Ad Litem*

The McCorriston firm also researched the appointment of an administrator *ad litem*. Trustee Stender and Jervis had filed a petition requesting that an administrator *ad litem* represent KS during the AG investigation. Aipa asked the McCorriston firm to research what effect an administrator *ad litem* would have on the operation and administration of Trust Estate. Contrary to Master Richards' assertion that this furthered only individual Trustee interests, Richards Rpt. at 72-73, we believe that this is clearly a Trust Estate issue. The prospect of the appointment of an administrator *ad litem* raised many questions and issues. To make an informed decision on whether to accept an administrator *ad litem*, the Board of Trustees was entitled to seek legal advice on the effect that such an administrator would have on the Trust Estate and on the Trustees' duties.

(3) Judge Chang and Judge King

The Trust Estate asked McCorriston to research the possibility of disqualifying Judges Chang and King. Trustee Peters had charged that Judge Chang was biased against the Trust Estate. The Trustees wanted McCorriston to investigate Judge King because of his involvement with the *Broken Trust* article, and because of various other statements he made that were prejudicial to the Trust Estate. The McCorriston firm researched these matters, but advised the Trust Estate that it could not bring an action. Notwithstanding Master Richards' criticism of this work, Richards Rpt. at 74, we found no impropriety here. The Trust Estate had a legitimate interest in evaluating whether the judiciary was biased and, if so, whether any remedy existed.

(4) Matsumoto's Endorsement of Governor Cayetano

Aipa asked the McCorriston firm to research the propriety of Master Matsumoto signing a campaign letter endorsing Governor Cayetano, which contained language endorsing the AG's investigation. McCorriston researched the issue and prepared a draft motion that he gave to Aipa, who circulated it to the Trustees. McCorriston stated that he was not involved in the similar motion that Trustee Wong filed on October 30, 1998. Our review produced no evidence that the McCorriston firm engaged in any impropriety in evaluating this issue.

C. Factual Investigations Undertaken by McCorriston Miller Mukai MacKinnon

During the course of the AG's investigation, KS requested that the McCorriston firm investigate the facts underlying certain transactions. The Trust Estate specifically authorized the McCorriston firm to conduct each of these investigations.

1. Milton Holt

In response to an AG subpoena requesting documents related to Milton Holt's KS credit card use, Aipa asked the McCorriston firm to conduct an internal investigation of this matter. According to McCorriston, the investigation was incomplete because he did not have an auditor to assist him in the investigation. Moreover, he did not interview Trustee Peters during the investigation. He did, however, interview KS staff, including Rodney Park. McCorriston submitted his findings to Aipa and recommended that KS terminate Holt's employment.

2. WASC Report

On June 2, 1998, the Board of Trustees directed McCorriston to investigate the leak of the WASC Report. Master Richards cited this work as an example of the firm's attempt to discredit KS's critics. *See* Richards Rpt. at 73-74. Contrary to Master Richards' suggestions of impropriety, however, the Trust Estate had an interest in ensuring the confidentiality of proprietary and sensitive information. The McCorriston firm, moreover, was not required to question the wisdom of the Board of Trustees' decision. The Board asked the McCorriston firm to undertake this work, and the request was within the Trustees' powers. The McCorriston firm was not required to question this undertaking.

3. Hamakua

The Trust Estate asked the McCorriston firm to investigate the basis for KS's decision to invest in Hamakua and the information the Trustees had at the time they made their decision. Allegedly, the Trustees did not perform a due diligence review prior to making the investment. The McCorriston firm prepared a report, which it gave to Aipa and the Trustees. The report found that the Trust Estate had incomplete records on the investment. McCorriston believed that the records were incomplete because the Trust Estate was not initially involved in the investment. The report found no wrongdoing and concluded that the four corners of the transaction were satisfactory.

4. Kalele Kai

Aipa asked the McCorriston firm to conduct a factual investigation of the Kalele Kai transaction. Aipa chose the McCorriston firm because MacKinnon had worked on the underlying real estate transaction, and therefore was familiar with the matters. MacKinnon was not asked to investigate any allegations of wrongdoing by the Trustees (*i.e.*, whether Trustees Wong and Peters received an inappropriate private benefit in connection with the transaction), but instead focused on the appropriateness of the underlying transaction. The McCorriston firm provided a factual report, which found that is was not improper for KS to engage in the transaction.

D. Miscellaneous Work Performed by McCorriston Miller Mukai MacKinnon

1. IRS and Conflict Issues

The Trust Estate asked McCorriston to research whether the Trustees had a conflict of interest in conjunction with the IRS matters. McCorriston advised the Trustees that they did not have a conflict. The Trustees, in their fiduciary capacity, were entitled to seek legal advice on all available options for responding to the IRS. We found no impropriety in McCorriston providing advice on this issue.

2. Grand Jury Investigations

The McCorriston firm did not have a significant role in the Grand Jury investigations. Lendio's limited assistance in producing documents in response Grand Jury subpoenas was the firm's only involvement in this matter. We found no evidence to suggest that this assistance was improper in any way.

III. APPLICATION OF THE LAW TO THE McCORRISTON MILLER MUKAI MacKINNON'S LEGAL WORK

A. McCorriston Miller Mukai MacKinnon Represented Trust Estate Interests

The Board of Trustees retained the McCorriston firm by unanimous vote to act as chief litigation counsel during the AG's investigation. The Trustees had the authority (and likely the duty) to hire such counsel to protect KS's interests. Our review indicates that the McCorriston firm sought to avoid representing anything but the interests of the Trust Estate, as determined by the Board of Trustees.

The Board of Trustees makes decisions for the Trust Estate based on a majority vote. A group of three Trustees can, therefore, vote to retain outside counsel and can similarly vote on what the scope of representation will be. A vote of three Trustees can also determine what actions are in the Trust Estate's interests. *See* Langbein at 3-4. Given this premise, we find no fault in the McCorriston firm acting pursuant to the direction of the majority.

As discussed in Part IV of this Report, the McCorriston firm was entitled to assume that Trustee decisions were proper, and was not obligated to question Trustee decisions, unless the work requested was obviously illegal or could in no way benefit the Trust Estate. *See* Leubsdorf at 7-8. We conclude that the McCorriston firm was not obligated to refuse any of the work that it performed. Nor was the firm required to question the legitimacy of the work that it was asked to perform. Although the McCorriston firm was perceived by many to be representing the individual interests of those Former Trustees who consistently voted in the majority, the documentary evidence and the evidence uncovered in interviews showed that the McCorriston firm represented the interests of the Trust Estate (even if those interests were at times defined by a simple majority of the Board). Furthermore, we found no evidence that, in following the directives of a majority of the Former Trustees, the McCorriston firm performed work that could in no way benefit KS. The McCorriston firm therefore acted appropriately.

B. No Basis Exists for a Professional Liability or Disgorgement Claim

We uncovered no evidence that the McCorriston firm violated any relevant rule of professional conduct. First, the McCorriston firm had no duty to disclose any alleged wrongdoing by the Trustees; there were no instances in which the McCorriston firm had actual knowledge of illegal conduct by the Trustees. Second, the McCorriston firm did not violate any of the Rules of Professional Conduct that govern the adequacy of representation. Third, we do not believe that the McCorriston firm violated the Rules of Professional Conduct setting forth standards governing conflicts of interest. As discussed above, we do not believe that Mukai's representation of Trustee Wong created an actual conflict of interest with respect to the

McCorriston firm's representation of the Trust Estate (as defined by the majority), but in any event, we think it would be extremely difficult to show any harm to the Trust Estate.

In our assessment, KS does not have any basis on which to assert a professional liability claim against the McCorriston firm. There is no evidence that the McCorriston firm breached its duties in its representation of KS; rather, the evidence supports a conclusion that the McCorriston firm performed its duties with the degree of care, skill, diligence, and knowledge commonly possessed and exercised by a reasonable, careful, and prudent lawyer in the practice of law.

Similarly, we do not believe that there is a basis for KS to assert a claim for disgorgement against the McCorriston firm. None of circumstances under which disgorgement may be appropriate applies here. We found nothing to support a conclusion that the McCorriston firm's "services were manifestly inappropriate" or that the firm "violated an obligation to inform the client of considerations indicating that the services should not [have been] rendered." Leubsdorf at 13. As discussed above, the representation did not involve a breach of professional duties to a client. *See id.* at 14. Nor did we find any evidence that the McCorriston firm performed work solely for the personal benefit of one or more Trustees or that the McCorriston firm represented both KS and individual Trustees in circumstances in which their interests diverged. *Id.* Finally, there is no evidence that the McCorriston firm's fees were excessive for this work.

C. Future Retention of McCorriston Miller Mukai MacKinnon

The decision to retain legal advisors is a matter of trust administration that falls within the Trustees' broad discretion. We believe that the Trustees should consider the foregoing summary of McCorriston's work for the Trust Estate in the 1997-1999 time period in reaching that decision. We found no basis that would prevent KS from retaining the McCorriston firm in the future.

SECTION FOUR - PROVIDER-SPECIFIC ANALYSIS FOR PITLUCK, KIDO, SATO & STONE

I. INTRODUCTION

In connection with our review of the Pitluck firm, we examined all relevant KS client files at the offices of the Pitluck firm and at KS and conducted a preliminary and follow-up interview of Wayne Pitluck. In the course of conducting interviews and document reviews related to other Providers, we received additional information and input regarding Pitluck.

Wayne Pitluck provided legal services to KS from at least 1989, if not earlier, on a limited basis. Nathan Aipa was an associate at the Pitluck firm in the early 1980's before he was hired by KS to serve as KS's first in-house counsel. When Aipa became KS General Counsel, Aipa began to engage Pitluck directly to work on various KS-related projects. Typically, Pitluck assisted Aipa in preparing KS policies and procedures, copyright manuals, fiduciary duty policies, and in reviewing contracts. Pitluck also worked on the restructuring of the financial aid and scholarship programs at KS. In the early 1990's, KS put Pitluck on a monthly retainer. Because Pitluck's retainer agreement assured a monthly salary, he did not prepare bills with actual costs for his time. Pitluck reported to Aipa and had very infrequent contact with the Trustees. Pitluck attended only one Trustee meeting and that was to make a presentation on antitrust issues (his former area of expertise), and could recall one other instance in which he met with Aipa and one Trustee.

Of the subject matters we considered during our review, we determined that the work performed by Pitluck in the following areas warrants a discussion in this Report: (1) work provided to KS in connection with the AG's investigation; (2) work related to the Trust Estate's investment in and Trustee Peters' directorship of Mid-Ocean Reinsurance Company, Ltd.; and (3) work related to the creation of P&C (the Trust Estate's wholly owned insurance subsidiary).

II. ISSUE-SPECIFIC DISCUSSION

A. The AG's Investigation

After the AG's investigation was announced in the summer of 1997, Aipa assembled a group of attorneys to meet regularly to assist him in responding to the issues raised by the investigation. Aipa selected Pitluck to participate in Monday morning meetings, along with Bruce Graham and Michael Hare. The sole purpose of these meetings was to deal with investigation-related issues as they arose and to provide Aipa with a sounding board. Given the concurrent investigations and information requests from the Master, the IRS, and the AG, coupled with in-fighting among the Trustees, Aipa required assistance in responding to the difficult issues raised and in maintaining some degree of normalcy. The Monday morning meetings were always focused on Trust Estate issues, not on individual Trustee issues. Pitluck was present at the meetings because of his institutional knowledge of KS matters, his corporate law background, and because he was an old friend of, and trusted advisor to, Aipa. Aipa stopped including Pitluck in the Monday meetings some time after Pitluck took an extended trip in the midst of the AG's investigation.

Pitluck also attended the Wednesday meetings initiated to deal with KS's response to the AG's subpoenas. The main subpoena response initiative was run out of the Cades firm, a decision that made sense given Cades' prior experience with large-scale KS document productions. Pitluck was brought in simply to assist on an as-needed basis. We found no evidence that Pitluck was aware of, or participated in, any stonewalling of the AG or the Master.

We found that, in connection with the AG's investigation, Pitluck not only put the Trust Estate's interests first, but strongly cautioned against actions that could give even the appearance of benefiting the Trustees individually. For example, on August 18, 1997, Pitluck gave Aipa comments on a draft letter from Bruce Graham regarding the role of legal counsel in the AG's investigation. In addition to several other comments, Pitluck emphasized that the Trust Estate's attorneys should not represent an individual Trustee in any KS business, irrespective of whether there was an actual conflict of interest. Pitluck also agreed with Graham's recommendation that the Trustees retain personal counsel. In a September 24, 1997 memorandum to Aipa containing discussion points for an organizational meeting with respect to the AG's review, Pitluck noted that it was critical to maintain the distinction between counsel representing the Trust Estate and counsel for the individual Trustees. Similarly, in a September 25, 1997 meeting, Pitluck discussed how best to differentiate liability exposure of the individual Trustees from that of the Trust Estate.

An October 1, 1997 memorandum that Pitluck drafted for Aipa's signature also reflected a concern that any conflict of interest be avoided. The memorandum provided Aipa with a suggested response to an earlier memorandum from Trustee Stender, which addressed the engagement of attorneys in connection with the AG's review. The suggested response stated "unequivocally" that:

> [T]he Office of the General Counsel and all attorneys retained by KSBE represent only the Estate and do not represent the interests of any individual Trustee. Great care is continually exercised by the General Counsel and by retained counsel to maintain the integrity of the representation.

The response went on to state that the mission of the Office of General Counsel and outside attorneys retained by KS was always to defend and protect the Trust Estate. In sum, there is no evidence that Pitluck espoused any position that placed individual Trustee interests ahead of those of the Trust Estate.

B. Mid-Ocean Reinsurance Company, Ltd.

As discussed previously in our provider-specific analysis of Ashford & Wriston, Aipa asked Pitluck to review KS documents pertaining to Mid-Ocean and to prepare a memorandum on the results of his review. Two memoranda resulted from Pitluck's document review—one dated September 10, 1997, and a second dated September 15, 1997. The memoranda provide little or no legal analysis and are more accurately described as a factual analysis of events contained in the KS documents.

As discussed in detail in Part III of this Report, the issue raised by Trustee Peters' service as a Mid-Ocean director was whether Trustee Peters was entitled to compensation for his seat on the Mid-Ocean Board of Directors and whether the Trust Estate should have paid Peters' travel expenses to and from directors' meetings. Pitluck did not interview Trustee Peters, not because he was prohibited from doing so, but simply because he was tasked only with a review of the documents. In his September 10 memo, Pitluck stated that it was clear from the KS documents that Mid-Ocean considered the directors to be independent and that the compensation paid was meant for the directors individually. On the other hand, Pitluck stated that "internal KSBE documents" suggested that Trustees served on the Mid-Ocean Board as KS representatives and not as individuals. Thus, Pitluck concluded that payment of compensation and travel expenses, as well as the existence of potential conflicts, turned on the nature of the director's seat. Language referring to the internal KS documents was omitted from Pitluck's September 15 version of the Mid-Ocean memorandum. The omission appears to have been inadvertent and not at the direction of Aipa, the Trustees, or KS. Pitluck stated there was no intent to cover up a conflict of interest, and we found no evidence to the contrary. Moreover, all of the KS documents originally provided to Pitluck—including those that suggested that the Trustees served on the Mid-Ocean board as KS representatives—were attached to the later version of the memorandum.

The absence of a conclusive opinion on the appropriateness of Trustee Peters' actions with respect to Mid-Ocean cannot be blamed on Pitluck, who completed the task that Aipa assigned to him. Aipa asked Pitluck to review documents and to determine the facts based on those documents. Aipa did not ask Pitluck to research or discuss the applicable law, or to apply the law to the facts as set out in the KS documents. Although Pitluck did not have an explanation for the omission of the reference to internal KS documents in his later memorandum—a reference that could suggest that KS had knowledge that Peters was involved in usurping a corporate opportunity—the record does not support a conclusion that Pitluck was involved in any attempt to cover up a conflict of interest.

C. P&C Insurance Company

Pitluck served as outside legal counsel for P&C, worked with Bobby Harmon on the development of P&C, and prepared all of the underlying corporate documentation for P&C. Pitluck's role as legal counsel to P&C was task oriented—P&C would request Pitluck's services, he would provide legal counsel, and bill by the hour. Pitluck's work on P&C was billed to the taxable subsidiary and not to the Trust Estate.

Pitluck was not asked to prepare management agreements for P&C and therefore is not responsible for any losses that P&C may have suffered as a result of a delay in the execution of those agreements. In our interview of Pitluck, he could not recall how J.H. Marsh and McLennan was selected to serve as the Trust Estate's insurance broker; Pitluck did not participate in the decision-making process. Pitluck was unaware of any conflicts of interest. or violation of arm's length dealings, in connection with P&C. We found no evidence to the contrary; nor did we find any evidence that Pitluck was negligent in carrying out the tasks that he was requested to complete, or that he breached any duty of professional responsibility in connection with P&C.

III. APPLICATION OF THE LAW TO PITLUCK'S LEGAL WORK

A. No Basis for a Professional Liability Claim

We conclude that KS has no basis for asserting a professional liability claim against the Pitluck firm. We found that Pitluck performed his duties with the degree of care, skill, diligence, and knowledge commonly possessed and exercised by a reasonable, careful, and prudent lawyer in the practice of law. We found no evidence that Pitluck breached any legal or professional duties related to the representation. Nor did Pitluck have a duty to disclose any alleged wrongdoing by the Trustees to the Probate Court or other third parties. Pitluck was unaware of any Trustee conduct he knew to be illegal.

Pitluck consistently and diligently performed the tasks and assignments KS requested. Indeed, our review indicated that Pitluck sought to protect the Trust Estate and to erase any appearance of a conflict of interest by him, other outside attorneys, or KS's in-house Legal Group. Perhaps his time descriptions (billed to "Trustees/Attorney General's Review") led to Master Richards' allegation that Pitluck was primarily concerned with individual Trustee interests. Even a cursory look at Pitluck's work product, however, reveals otherwise. It is apparent that Pitluck's efforts were devoted to attempting to resolve conflict-of-interest issues and advising KS attorneys that they could not represent individual Trustee interests. Moreover, there is no evidence that any conflict of interest occurred.

B. No Basis for Disgorgement of Legal Fees Paid to Pitluck

We also conclude that there is no basis for KS to assert a claim for disgorgement of legal fees against the Pitluck firm. We uncovered no evidence that Wayne Pitluck's fees were excessive or unreasonable. Nor did he engage in any clear and serious violation of the applicable standard of care. Finally, as discussed *supra*, we found no evidence that Pitluck performed work for individual Trustees, or that he or the Pitluck firm represented both KS and individual Trustees in circumstances in which their interests diverged.

C. Recommendations

In exercising their discretion to retain the Pitluck firm in the future, the Trustees should consider Pitluck's past work, thoughtful advice, and assistance to the Trust Estate. We have found no basis that would prevent KS from retaining the Pitluck firm in the future.

SECTION FIVE - PROVIDER-SPECIFIC ANALYSIS FOR VERNER, LIIPFERT, BERNHARD, MCPHERSON & HAND

I. INTRODUCTION

In performing our review of Verner Liipfert, we examined in excess of forty boxes of KS client files related to the areas under review and interviewed John Waihee, Norma Wong, Denis Dwyer and Susan Temkin. In the course of conducting interviews and document reviews related to other Providers (including our review of the Trust Estate's files), we received additional input and information regarding Verner Liipfert.

KS initially engaged the firm of Verner Liipfert in December of 1994 to handle various matters, including possible defamation claims by the Former Trustees against Cable News Network. A number of additional assignments were made over time. During the course of our review, we determined that work Verner Liipfert performed for KS in the following areas calls for a discussion in this Report: (1) the change in domicile and tax status project that commenced in late January of 1995 and continued at least into 1997; (2) the intermediate sanctions lobbying effort that spanned the period September 1995 to July 1996; (3) the work Verner Liipfert performed over the period August 1997 to May 1999 to attempt to justify to the Master and the Probate Court the intermediate sanctions lobbying effort; and (4) the work Verner Liipfert performed in responding to the AG's subpoenas and inquiries.

II. ISSUE-SPECIFIC DISCUSSION

A. Possible Change in Domicile and Tax Status

KS undertook an evaluation in early 1995 to consider a possible change in domicile to another jurisdiction and a possible conversion to taxable, rather than tax-exempt, status.

According to Verner Liipfert time sheets, the first discussion concerning the transfer of domicile project occurred on January 31, 1995, at meetings Waihee had with various Trustees. Thereafter, this project received significant attention, along with a project to investigate a change in the Trust Estate's tax status. Doug Adler was the lead attorney for the transfer of domicile project; Susan Temkin was the lead attorney for the tax-conversion project.

The domicile/tax-status project had various facets. Early file memoranda and handwritten notes of Verner Liipfert personnel demonstrate that a number of areas were under investigation, including: (1) the reasonableness of Trustee compensation under section 501(c)(3) of the Code; (2) whether federal law preempted state law on Trustee compensation; and (3) the availability of other domiciles that might be more favorable than Hawaii. In this context, the issue of Trustee compensation was identified as one that was then pending before the IRS National Office. By the beginning of June 1995, various documents had been prepared and were forwarded to KS General Counsel Nathan Aipa. These materials included two memoranda on Trustee compensation issues, one memorandum on factors to be considered in a possible transfer of domicile, and one memorandum on tax-exempt versus taxable status.

Both memoranda on Trustee compensation are dated June 2, 1995 and include a fourteen-page comprehensive memorandum as well as a six-page executive summary on the same issue. A focus of the comprehensive memorandum is whether, with respect to the large commissions taken by KS Trustees, the IRS could successfully assert that the Trustees had received unreasonable compensation, thereby putting the Trust Estate's tax-exempt status at risk. One of the factors to be evaluated was whether the doctrine of preemption or any similar doctrine would require the IRS to accept the state statutory commissions formula for Trustees as establishing a reasonable level of compensation for federal tax purposes. For purposes of the reasonableness of Trustee compensation, the comprehensive memorandum discusses the applicable legal standards developed under section 162 of the Code, including the fact that the IRS uses similar criteria for both taxable and tax-exempt organizations. With respect to the possible preemption of state law on Trustee compensation, the memorandum discusses various conflicting authorities on whether state law would control. In the context of this analysis, the memorandum notes that a 1994 Treasury Department proposal on intermediate sanctions would have created a rebuttable presumption that compensation set by an independent board or committee was reasonable.

With respect to a possible change in domicile, another Verner Liipfert memorandum transmitted to Nathan Aipa on June 2, 1995 identifies various criteria to be considered, including trustee/non-profit liability issues, trustee standards of conduct, governance restrictions (including those on trustee compensation), tax-status issues (tax-exempt versus taxable), and the degree of state oversight and enforcement. These issues were examined in greater detail in a comprehensive memorandum Verner Liipfert prepared in August.

The final June 2 memorandum covers the tax-exempt versus taxable status issue. This memorandum notes that Congress imposed an "exit tax" on private foundations that sought to convert their status from tax-exempt to taxable, and that if the intermediate sanctions provisions were extended to public charities, a similar "exit tax" could be imposed, which would make it difficult to convert to taxable status. The memorandum also discusses potential benefits of becoming taxable. These benefits include: the avoidance of federal and state scrutiny as a public charitable organization; the ability to control the timing of conversion (as opposed to having the IRS revoke the organization's tax-exempt status involuntarily); the fact that Trustee compensation would be governed by state law (not federal law); the ability of Trustees to control the day-to-day activities of KS's taxable subsidiaries; and the ability of KS to engage in political activities without having to be concerned about the effect of those activities on its tax-exempt status.

In a June 16, 1995 telephone conference with Verner Liipfert personnel, Bruce Graham expressed his view that both the Probate Court and the AG would have to agree to a change in the Trust Estate's domicile, and that this was "highly unlikely" to occur. Notwithstanding Graham's advice, approximately two months later, Verner Liipfert forwarded to Trustee Jervis an 82-page report, dated August 1, 1995, and entitled "Relocation of Trust Domicile: Comparative Survey of State Laws and Tax Consequences for Kamehameha Schools Bishop Estate." Although the survey made no specific recommendation, it did include memoranda assessing the potential benefits of moving the Trust Estate to the Cheyenne River Sioux Nation and reiterating the potential benefits of becoming taxable versus remaining tax-exempt. Notes of Douglas Adler of an October 11, 1995 meeting with Nathan Aipa refer to the domicile/tax-status project as "political dynamite" and reflect that Verner Liipfert was instructed to "get [the] research done and leave [it] on [the] shelf." An October 16, 1995 Verner Liipfert memorandum reflects Bruce Graham's belief that "the Attorney General would probably challenge such a move and . . . the Courts would likely permit him/her to intervene." According to the memorandum, Graham also believed that the Hawaii courts would "retain jurisdiction" over KS were it to move.

On November 27, 1995, Norma Wong sent Trustee Jervis a memorandum concerning the possible conversion to taxable status, noting that an "exit tax" provision in the then-pending intermediate sanctions legislation had been removed, thereby removing a potential bar to conversion (as had been previously identified in the June 2, 1995 memorandum on taxable versus tax-exempt status).

The issue of a possible conversion to taxable status was resurrected in April of 1996. On April 19, 1996, Nathan Aipa instructed Susan Temkin to prepare a memorandum on the consequences of KS converting to taxable status; Verner Liipfert drafted various materials in response to this request in June of 1996. According to Verner Liipfert's time sheets, activity with respect to these issues continued into 1997. Although it appears that steps were never taken to effectuate a change in KS's domicile or tax status, Verner Liipfert was paid in excess of $250,000 for the domicile/tax status project.

During our interviews with Verner Liipfert personnel, they defended the domicile/tax status project as a reasonable area for investigation. John Waihee stated that it may have been a long shot that the domicile or tax status would ultimately change, but that does not mean it was unreasonable to investigate the options thoroughly. The project was carried out under the supervision of Nathan Aipa and with the active involvement of Trustee Jervis. We found no evidence indicating that it was inappropriate for Verner Liipfert to undertake this project. Verner Liipfert was entitled to assume that the project was a proper exercise of Trustee powers and was undertaken to explore available options. In reaching this conclusion, we by no means endorse the decision of the Former Trustees to undertake this project and note that the Interim Trustees previously cited this project as one of the grounds for removal of the Former Trustees.

B. Intermediate Sanctions Lobbying Effort

On April 24, 1995, Verner Liipfert opened a new matter entitled "Strategy for Dealing with National Trends in Non-Profits." Within days, John Waihee transmitted to the Former Trustees a memorandum regarding an April 25, 1995 *Wall Street Journal* article on KS and a tax conference at which this article was highlighted. At this conference, one of the speakers, Michael Superata, counsel to the House Committee on Oversight of the House Committee on Ways & Means, expressed his surprise at the article's assertion that the KS Trustees received $900,000 in annual compensation.

On September 15, 1995, Susan Temkin, Denis Dwyer, and Suzanne Cartwright forwarded a memorandum to John Waihee and Norma Wong concerning the "Chairman's Mark" on proposed legislation that provided for intermediate sanctions. Attached to the September 15 memorandum is an explanation provided by the House Ways & Means Committee, as well as the actual legislative language. The Ways & Means Committee explanation states that the legislation would apply existing tax law standards for determining the reasonableness of compensation. The explanation also notes that a rebuttable presumption of reasonableness would be created if a compensation arrangement was approved by an independent board (or an independent committee authorized by the board), and that data for functionally comparable positions from both taxable and tax-exempt organizations may be used in determining whether a particular compensation arrangement is reasonable. Of particular significance is a footnote (the so-called "state law footnote") indicating that a state law or state agency determination will *not* be determinative for purposes of establishing the reasonableness of compensation. The explanation further indicates that an "exit tax" would be imposed to prevent an organization from avoiding intermediate sanctions through termination of its tax-exempt status.

Within days of the release of the Chairman's Mark, Verner Liipfert had worked with several of the Trustees, notably Trustee Wong, to develop a basic strategy to defeat the proposed intermediate sanctions legislation. In a September 22, 1995 memorandum to the Former Trustees, Verner Liipfert stated that the lobbying strategy was to keep intermediate sanctions out of the Senate version of the bill and to prepare "an acceptable fall back position if it becomes an absolute political necessity for Congress for there to be some language in the bill that addresses the general issue of the accountability of charitable organizations."

The memorandum also identifies potential allies to support the KS position and states that "[t]his strategy hopes to place Bishop Estate *among others that will be affected*" (emphasis in original). To carry out this overall strategy, Verner Liipfert drafted letters opposing the intermediate sanctions legislation for the Hawaiian Congressional Delegation to send to, among others, the Chairman of the House Ways & Means Committee (the Honorable Bill Archer) and the leading Democrat on that committee (Congressman Gibbons). As noted below, responses were subsequently received from these members of the House Ways & Means Committee.

Part of the KS strategy was to find allies, particularly those who might be constituents of key members of the House Ways & Means Committee or the Senate Finance Committee. Verner Liipfert periodically prepared assignment sheets detailing the responsibility of various individuals to contact other organizations, members of Congress, or Congressional staff members. These assignment sheets were updated from time to time to ensure that all necessary contacts were made.

By memorandum dated October 4, 1995, Verner Liipfert again outlined the basic strategy to defeat the legislation, but also indicated the potential for backup positions in the event the legislation proceeded ahead. In reiterating the basic strategy, the memorandum states:

> It cannot be over-emphasized that our first objective is to remove the interim sanctions in their entirety from the proposed legislation. If this objective cannot be accomplished in [its] entirety, and Congress is compelled politically to address the general issue of interim sanctions, we must consider ways to amend the current proposal in a way that will minimize adverse impacts to the institution.

One of the first fallback positions called for deleting the state law footnote or modifying it so that existing state law mechanisms for determining compensation would be presumed reasonable.

Other fallbacks included removing the provision for an "exit tax" and creating an exemption for all educational institutions (such as KS).[29]

In response to earlier correspondence from the Hawaiian Congressional Delegation. two key members of the House Ways & Means Committee wrote letters regarding the proposed legislation. In a letter dated October 6, 1995, the Chairman of the Committee (Bill Archer) emphasized that intermediate sanctions were designed to help, not hurt, charitable organizations by providing an alternative to revocation of their tax-exempt status. He also noted that under current law, the only penalty for improper inurement was to revoke an organization's tax-exempt status, whereas intermediate sanctions would permit individuals who received a prohibited benefit to be penalized, rather than the institution. On October 19, 1995, Congressman Gibbons underscored some of the same themes. He noted his awareness of the level of compensation being paid to KS Trustees, stating that: "I assume this is the situation about which you contacted me and the press continues to express interest." This letter also emphasizes that a safe harbor is available so long as the compensation arrangement is approved by an independent board (or committee) using comparable compensation data in arriving at the salary levels. The Archer/Gibbons letters underscore that the intermediate sanctions legislation was in KS's interests and provided KS with a satisfactory safe harbor mechanism.

In a memorandum dated November 16, 1995, Verner Liipfert informed the Former Trustees that the conferees had agreed to certain changes to the intermediate sanction proposal, but concluded that "none of these changes are [*sic*] likely to provide us with the relief that we

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29 As proposed, the bill contained an exit tax that would be imposed on tax-exempt organizations that terminated their tax-exempt status in order to avoid the application of intermediate sanctions. The effect of such an "exit tax" would be to require an organization to pay a tax equal to the lesser of the value of its net assets or the cumulative and aggregate tax benefit it had received as a result of its exemption under section 501(c)(3).

need." Consequently, the strategy continued to be to "[s]eize any opportunity to delete the provision." In a memorandum dated November 22, 1995, Verner Liipfert outlined in greater detail improvements to the bill, including the deletion of the "exit tax." This memorandum also highlights an addition to the conference report language, which stated that section 162 standards would be applied under applicable tax law in determining the reasonableness of compensation. The memorandum questions whether this added language "is a sufficient improvement for KSBE purposes."

Even with these changes, KS's strategy continued to focus on defeating the legislation. In a November 21, 1995 conversation between Denis Dwyer and Trustee Wong, Trustee Wong stated that he "want[ed] to kill it again." Furthermore, in a November 27, 1995 memorandum to Trustee Wong from Stu Spencer of the firm of Hecht, Spencer & Associates, Spencer states that KS's "number one goal is elimination of the interim sanctions provisions." Finally, a November 29, 1995 communication reflects Susan Temkin's understanding that "our marching orders are going to be to kill the intermediate sanctions legislation." About this time, *U.S. News and World Report* singled out KS as the only tax-exempt organization actively opposing intermediate sanctions.

By early 1996, when it became clear that Congress would enact the proposed legislation in some form, Verner Liipfert began to focus its efforts on modifying provisions in the bill. The thrust of these efforts, however, continued to be to protect Trustee compensation. In a memorandum dated February 16, 1996, Denis Dwyer noted that the state law footnote was clearly aimed at KS and prevented the use of the state statutory formula for trustee compensation. An attachment to the memorandum entitled "Intermediate Sanctions Report Language" describes three changes to the House conference report language that Verner Liipfert was seeking. The first proposed change sought the addition of language providing that compensation for a person performing services for a tax-exempt entity would be the same as compensation for those performing services for a taxable organization. A second proposed change sought the addition of language that would establish a rebuttable presumption if the Probate Court approved the Trustees' compensation. Finally, Verner Liipfert sought to modify the state law footnote to provide that a determination by a state or local legislative or judicial entity was a factor to be considered in determining the reasonableness of compensation. It is apparent from these materials that KS sought to reverse or neutralize the state law footnote in order to preserve the use of the state statutory formula for calculating Trustee compensation.

On March 23, 1996, Susan Temkin forwarded a memorandum to Trustee Wong stating that changes made to the Joint Committee on Taxation's description of the soon-to-be-enacted intermediate sanctions provision now made it clear that a board of trustees can take advantage of the rebuttal presumption of reasonableness. Another consideration addressed in the March 23 memorandum is the requirement of advanced committee approval of compensation in order to take advantage of the rebuttable presumption of reasonableness. The memorandum questions "whether this safe harbor provision can be utilized by obtaining an advanced approval of a compensation formula, which amount would be subject to the ceiling of the state's statutory amount." If so, obtaining advance approval to use the state law formula would effectively keep in place the state law mechanisms for calculating trustee commissions.

By memorandum dated May 5, 1996, Verner Liipfert sent to Trustee Wong a proposed colloquy between Senator Inouye and Senator Roth that was intended to mollify the effect of the state law footnote on Trustee compensation by clarifying that state law was a factor to consider in determining the reasonableness of compensation, but was not controlling. This effort ultimately failed when Senator Roth refused to participate in the colloquy. By July, it was obvious that the intermediate sanctions legislation would pass and that the state law footnote would be retained. In that context, Trustee Jervis requested a memorandum from Verner Liipfert discussing whether state law would be preempted. In a memorandum dated July 2, 1996, Verner Liipfert concluded that it was not clear state law would be preempted.

During the period April 1995 through July 1996, Verner Liipfert was paid approximately $900,000 for this lobbying effort. The contemporaneous documentation indicates that the two primary lobbying objectives were (1) to defeat the legislation (September - November 1995) and (2) to delete or neutralize the state law footnote so that existing state law mechanisms would be determinative of the reasonableness of Trustee compensation for federal tax law purposes as well (December 1995 - July 1996).

In our interviews of Verner Liipfert personnel, they strongly defended their lobbying efforts. Although they acknowledged that their initial strategy was to "kill" the legislation, they claimed that they wanted only to remove the legislation from the fast track it was on to allow for a more careful and in-depth consideration of the proposal. (We found scant support for this interpretation of their strategy in the contemporaneous documentation.) They claimed that there were a number of important issues that needed to be examined in detail before enactment, including (1) the potentially broad range of employees that might be subject to the penalty taxes imposed by the legislation, (2) the "exit tax" that could have resulted in the forfeiture of all or most of an organization's assets, and (3) the lack of a clear safe harbor mechanism for trusts generally and trustees in particular. Verner Liipfert claimed that once the strategy to defeat the legislation failed, they shifted their strategy to supporting the legislation and to seeking a safe harbor mechanism (a rebuttable presumption) for all KS personnel (Trustees included). Verner

Liipfert claims that its efforts over the period December 1995 to July 1996 were principally devoted to that objective.

We found nothing to indicate that there was any impropriety, as a legal or professional matter, in Verner Liipfert undertaking this lobbing work at the Former Trustees' request. Verner Liipfert was entitled to assume that the decision to lobby was made pursuant to a proper exercise of the Former Trustees' powers and that the Former Trustees had good faith reasons for exploring options and taking positions. For example, from the standpoint of Verner Liipfert, it was not implausible for the Former Trustees to undertake lobbying to protect their compensation levels, claiming that KS has a interest in attracting qualified candidates to serve as Trustees and paying them at competitive levels. Verner Liipfert was not bound to inquire whether the Former Trustees had the power to make this decision or were properly exercising that power. Without actual knowledge that the Former Trustees were exceeding their powers or improperly exercising them, it cannot be said that Verner Liipfert's decision to undertake the lobbying was improper. We found no evidence indicating that Verner Liipfert had actual knowledge that the Former Trustees' decision to lobby with respect to the proposed intermediate sanctions legislation exceeded their powers or was an improper exercise of them. In reaching this conclusion, however, we again emphasize that we do not endorse the decision of the Former Trustees to undertake this lobbying effort and note that the Interim Trustees likewise cited this project as a ground for removing the Former Trustees.

C. Efforts to Justify the Intermediate Sanctions Lobbying Project to the Master and to the Probate Court

We now turn to a more troublesome issue, that is, whether Verner Liipfert accurately described the lobbying effort in accounts presented to the Master and to the Probate Court.

On August 9, 1997, the *Broken Trust* article was published in the *Honolulu Star-Bulletin* criticizing, among other things, the intermediate sanctions lobbying effort. Shortly thereafter, Verner Liipfert undertook extended efforts on behalf of the Former Trustees to explain this lobbying effort. As is discussed in detail below, two letters and a memorandum were drafted for submission to the Master or to the Probate Court that omit and/or misstate certain facts about KS's lobbying efforts. Taken as a whole, these letters and the memorandum fall far short of the kind of candid explanation a KS representative should provide to a court-appointed Master, or set out in documents that might be filed with the court.

On October 27, 1997, Verner Liipfert retained the services of PWC to assist Verner Liipfert in responding to anticipated requests for information regarding the Trust Estate's lobbying effort. This was done to ensure that PWC's work was protected by the attorney-client privilege. In conjunction with that retention agreement, Verner Liipfert provided PWC with various drafts of materials, dated October 27, 1997, purporting to describe the intermediate sanctions lobbying effort. PWC eventually prepared draft comments, dated January 13, 1998, and subsequently provided these comments to Verner Liipfert.

PWC pointed out that Verner Liipfert was relying upon comments submitted by the American Bar Association and other organizations in a rulemaking context rather than in the legislative process. PWC felt that these regulatory comments, which were made in 1997, were "confusing, if not misleading," when used to explain the legislative process that occurred over the 1995-96 time period. PWC comments highlighted Verner Liipfert's omission of any discussion of the legislative history from 1993 and 1994 and suggested that one be added. PWC also raised the question of when the intermediate sanctions proposals first came to the attention of the KS Trustees (*i.e.*, in 1993). (The Verner Liipfert memoranda suggested that the KS Trustees first became aware of intermediate sanctions legislation in 1995.)

These draft materials were not used for any purpose until 1998, when the Master asked for information concerning the intermediate sanctions lobbying. By letter dated June 10, 1998, Colbert Matsumoto wrote to Bruce Graham requesting, among other things, the justification for the expenditures, the specific objectives sought to be achieved, the actual amounts expended, and any relevant reports related to the lobbying activity. Thereafter, Nathan Aipa requested that Susan Temkin respond directly to the Master. Temkin drew heavily upon Verner Liipfert's earlier draft materials in responding to the Master.

1. Temkin Letter of August 3, 1998

By letter dated August 3, 1998, Temkin submitted a thirteen-page, single-spaced letter providing background information on the lobbying effort. Her letter did not respond to the specific issues the Master raised in his June 10 request. Rather, the letter was based on the draft materials discussed above and was factually inaccurate or misleading in various respects.

At the outset, Temkin noted that she would be providing privileged and confidential information to the Master, but that such disclosure would not constitute a waiver of the attorney-client privilege. Next, despite PWC's earlier cautions about the potential to mislead, Temkin quoted from ABA comments made in 1997 and stated that various concerns that the ABA raised in response to the IRS's proposed intermediate sanctions regulations were the same that "motivated KS to embark on a legislative effort to seek reasonable guidance regarding the implementation of this potential legislation."

Ignoring PWC's suggestion to cover the 1993-94 legislative hearings on intermediate sanctions, the letter refers only to he 1995-96 legislative history and then states that "no Congressional committee had ever held hearings to consider thoroughly the specific proposal incorporated into the House Ways and Means Committee's Revenue Reconciliation Bill." The letter further asserts that, because of an unwillingness to entertain clarifications on the intermediate sanctions provisions, KS and other affected tax-exempt organizations, such as educational institutions and ecclesiastical bodies, were forced to oppose the House Ways & Means proposal as a matter of legislative strategy. The contemporaneous documents, however, do not evidence such a "legislative strategy," nor do they identify any other organizations or individuals opposing intermediate sanctions. The letter also identifies various improvements made in the November 15, 1995 Conference Report and contends that KS decided to support intermediate sanctions after these improvements were made. But the contemporaneous documents establish that, notwithstanding the November changes, the strategy continued to be to defeat the legislation.

2. Temkin Letter of September 18, 1998

After receiving Susan Temkin's August 3 letter, Colbert Matsumoto sent a three-page letter to Ms. Temkin requesting additional information and outlining twelve specific areas to be addressed. In a letter dated September 18, 1998, Temkin responded to the Master's August 6 letter. As detailed below, there are a number of instances in which Verner Liipfert again provided evasive or incomplete answers to the Master's questions.

For example, the Master asked who was involved from the law firm and what their respective roles were. Temkin responded that it was not feasible to provide a meaningful description of the role of each person involved, notwithstanding the existence of the Verner Liipfert assignment sheets that were regularly circulated to the lobbying team and the availability of billing statements. It is clear that it would have been feasible to provide these documents to the Master, but she chose not to do so. Indeed, by a memorandum dated October 15, 1998, Temkin provided Nathan Aipa with a description of the roles of Verner Liipfert personnel in KS's lobbying effort.

In response to the Master's request for a complete set of billing records and files for the Master's review, the letter asserts states that the Verner Liipfert files and billing records "are extensive, making it impractical to duplicate and transport them," even though the relevant billing records are only an inch thick. In addition, Verner Liipfert sent the Trustees regular status reports on the lobbying effort, which could easily have been given to the Master. Indeed, a few weeks later, Verner Liipfert provided Nathan Aipa with a list of the relevant status reports and stated that they contained a good description of the lobbying effort.

The Master also asked the following questions: (1) what specific impact did the intermediate sanctions proposals have on KS, other than on Trustee compensation; (2) what concerns did the Trustees express about KS employee compensation, as opposed to Trustee compensation; (3) how did concerns raised by other tax-exempt organizations differ from KS's; and (4) were the legislative efforts successful and what were the specific successes? In response to these four questions, the letter states that the legislative effort "was not designed to protect any *particular* level of trustee compensation and, as enacted, did not offer such protection" (emphasis added). This statement may be accurate in that no "particular" dollar level was sought. The question the Master posed, however, was whether there was any "impact" of the lobbying effort other than on Trustee compensation. The letter next refers to the "exit tax" as the most problematic provision in the legislation, stating that "KSBE and other tax-exempt organizations vigorously opposed the exit tax, which, fortunately, was eliminated in the Conference Agreement." These statements are misleading in that KS sought to defeat the legislation outright and the concern about the "exit tax" was only a fallback position. Moreover, KS sought to defeat the legislation even after the "exit tax" was removed in mid-November 1995.

Temkin's September 18, 1998 letter expresses grave concern about the impact of the legislation on KS employees. Although she professes concerns about the scope of the phrase "disqualified persons" and the uncertainty as to how the legislation would apply to KS employees, her letter does not respond directly to the Master's inquiry about the *specific* concerns expressed by the Trustees and the *particular* employees who were the focus of those concerns. The letter also claims that through KS's legislative efforts, KS "gained a safe harbor to determine the reasonableness of transactions between KSBE and a disqualified person if that person is not a trustee." The contemporaneous documents, however, do not indicate that KS was concerned about non-Trustee compensation or ever sought the change in question, *i.e.*, to make it explicit that a "board of trustees" could serve as an independent board for purposes of creating a rebuttable presumption as to the reasonableness of employee compensation.

Finally, the letter states that "it is evident that KS was successful, among others, in helping to encourage passage of legislation that would protect trust assets and would impose a significantly reduced burden in time and money to administer. The value of this effort can only be measured in years to come, as the existing and future trustees comply with the new laws and related regulations." Again, the contemporaneous documentary record does not support the claim that KS encouraged the passage of the proposed intermediate sanctions legislation.

3. Memorandum of October 15, 1998 and Subsequent Events

After reviewing Verner Liipfert's letters of August 3 and September 18, 1998, Master Matsumoto issued his First Supplemental Report. Therein, the Master concluded that the legislative efforts of the Former Trustees were "predominantly directed at preserving the historical procedure for determining compensation of the Trustees under state statutory law and minimizing the potentially adverse impact that the Intermediate Sanctions Law would have on their continued ability to receive compensation with and at the levels permitted under state law." On that basis, the Master found that the expenditure of funds and other Trust Estate resources for such efforts were not necessary or reasonable to carry out the purposes of the Trust Estate and recommended that those amounts be surcharged to the Former Trustees.

Following the issuance of the Master's Supplemental Report, Susan Temkin directed a memorandum to Nathan Aipa, dated October 15, 1998, responding to that Report. This memorandum was submitted to the Probate Court through an affidavit of Trustee Wong, dated October 15, 1998. The memorandum states that "we are not aware of any facts which support the Master's conclusion or the imposition of a surcharge on the KSBE Trustees," and that "the facts demonstrate[s] that their aim was to defeat the disastrous 'exit tax' and gain for the Trust objective guidance that the Trust's transactions with disqualified persons, including transactions involving Trustee compensation, would comply with the new statutory requirements." When these statements are measured against the contemporaneous documents, however, they are highly questionable. For example, documents from the September-November 1995 time period show that the aim of the Former Trustees was to kill the legislation in its entirety. Defeating the "exit tax" was a mere fallback position; even after its removal, KS sought to kill the legislation. Thus, the memorandum is incorrect when it states later that "[w]ith the elimination of the exit tax, the Trust decided to support intermediate sanction legislation."

The October 15 memorandum also criticizes the Master for recommending that a plan for determining Trustee compensation be implemented while simultaneously telling the Trustees they could not take action (*i.e.*, lobbying) to obtain objective guidance to ensure compliance with the law. Again, however, the contemporaneous documents show that as of September 1995, existing tax law standards for determining reasonable compensation would apply, which included the use of both taxable and tax-exempt entities as comparables, and KS had the option of using an independent board (or a committee authorized by the board) to establish the rebuttable presumption of reasonableness.[30] In our view, these guidelines provided more than enough objective guidance for the Trust Estate to submit a Trustee compensation plan, as it finally did in November of 1998.

The Verner Liipfert memorandum states that the lobbying effort

> had *no* effect on the specific amount, level or duration of such compensation. Only the most skewed analysis would conclude that this effort, which directly affected the Trust's planning, administration, budgeting, and recruiting, was 'predominantly directed' at benefiting individual Trustees.

The contemporaneous documents do provide support, however, for the view that the lobbying was "predominantly directed" at protecting existing mechanisms for determining Trustee compensation. The effort to defeat the legislation and later to provide a means by which existing state law mechanisms for determining Trustee compensation could continue to be used was an effort to preserve the status quo.

The memorandum states that its primary objective was not the preservation of a "particular compensation mechanism," and that the Trust Estate's position was "outcome neutral." For the period December 1995 through July 1996, however, it is difficult to understand how the Trust Estate was not seeking to preserve a particular compensation mechanism. By

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30 The relevant report language in September 1995 referred to use of "an independent board (or independent committee authorized by the board)." Under this language, the KS Trustees had the option of appointing an independent committee to set their compensation. In March 1996, the relevant report language was modified to make clear the independent board concept applied to "a board of directors or trustees (or committee thereof)." The modified language accompanied the legislation, as enacted.

seeking to delete or neutralize the state law footnote. KS sought to rely upon existing state law mechanisms.

Finally, Temkin's memorandum states that "none of our work 'affected' Trustee compensation, except in the larger sense that the intermediate sanctions legislation 'affected' *all* Trust transactions with disqualified persons, including the Trustees." Where the objective was to maintain the status quo in terms of how Trustee compensation was set, however, it is difficult to see how this work did not affect Trustee compensation. An objective reading of the contemporaneous documentation indicates that Trustee compensation was the driving force behind the lobbying effort.

Following the October 15 memorandum, Verner Liipfert continued to collect materials and prepare presentations to tell its version of the intermediate sanctions lobbying effort. This work continued through May 7, 1999, when the Former Trustees were removed on an interim basis. For the period August 1997 (when the effort to justify the lobbying effort began) through May 1999, it appears that the Trust Estate was billed over $600,000 and paid approximately $530,000 for work related to this "justification" effort. The time was first billed to "TRS/General Matter (No. 05175.0001)" and later to "TRS/Annual Accounts 109-11 Matter (No. 05175.0001)," with a small amount of related time billed to "National Trends—Non-Profits Matter (No. 05175.0016)." The time in these categories related to, among other things, the indexing and review of all the relevant files, the examination of attorney-client privilege issues on what documents might be subject to disclosure, and extensive discussions and drafting of documents concerning the intermediate sanctions lobbying effort.

During our interview of Susan Temkin, she sought to defend vigorously her three submissions. In general terms, she emphasized that KS had no choice but to try to defeat the legislation as a matter of legislative strategy because of the refusal of Congressional staff to consider modifications on important issues (such as the scope of the term "disqualified person." the "exit tax." and the lack of a clear safe harbor mechanism for trusts). She claimed that KS supported the legislation after November 1995, but sought objective guidance for trusts. She felt that her three submissions accurately communicated these strategies. Temkin claimed that her August 3 letter was written as a general statement on the lobbying effort and not in direct response to the Master's June 10 letter. As to her September 18 letter, she stated that she supplied the Master with as much information as was then readily available and in a form that could be reasonably transferred to him. As to her October 15 memorandum to Nathan Aipa, she claimed to be unaware that it would be filed in court, and stated that she would have written it differently (*i.e.*, not as openly critical of the Master) if she had known how it was going to be used.[31]

The contemporaneous documents tell a different story of the Trust Estate's lobbying efforts from the one described in the three Temkin submissions. On the other hand, Temkin's view is supported in large part by others involved in the lobbying effort, such as Denis Dwyer, John Waihee, and Norma Wong. Similar positions were also advanced by Trustee Wong in his deposition last Fall in connection with the Interim Trustees' petition for permanent removal.

[31] Temkin's purported lack of awareness of how this document would be used is questionable. Prior to her October 15 memorandum, there were regular communications with William McCorriston, including a discussion of the "filing" as well as the "filing deadline" for responses to the Master's First Supplemental Report (*i.e.*, the October 16 due date for submissions by individual Trustees). A draft of her memorandum was provided to McCorriston, and comments were received on the draft before it was finalized. Once it was finalized, copies were sent to McCorriston and counsel for the individual Trustees. Trustee Wong executed an affidavit on that same date, attaching the Temkin memorandum, and had the affidavit filed with the Probate Court on October 16, along with Trustee Wong's objections to the Master's First Supplemental Report. In addition, the October 16 Probate Court submissions of Trustees Peters and Lindsey quoted at length from Temkin's October 15 memorandum.

Thus, as discussed further below, it is clear that a significant factual dispute would be presented in any attempt to determine which story is the more accurate one.

D. AG Subpoenas

Significant time was also devoted to Verner Liipfert's response to two of the AG's subpoenas, Nos. 98-159 and 98-210. Much of the time was charged to a matter entitled "Subpoena No. 98-159 (Matter No. 05175.0024)," although some time was also billed to the category of "TRS/General (Matter No. 5175.0001)." Subpoena Nos. 98-159 and 98-210 requested documents related to KS's intermediate sanctions lobbying effort.

The contemporaneous documents show that these subpoenas raised significant attorney-client privilege issues. Pleadings were drafted to seek a protective order limiting the production of documents to non-privileged ones. Ultimately, the Attorney General agreed to withdraw Subpoena No. 98-159 and to substitute in its place Subpoena No. 98-210, which called for a more limited scope of documents related to the lobbying effort. Based on discussions between Verner Liipfert and Lawrence Goya, of the AG's Office, an agreement was reached to provide the AG with three categories of information and documents (a general description of Verner Liipfert's work on intermediate sanctions; a summary of the legal fees and expenses; and documents written on behalf of KS to members of Congress).

Based on a review of the status reports on subpoena compliance and the relevant pleadings files, it does not appear that these two subpoenas were formally contested or that there was any dispute as to the completeness of the response to Subpoena No. 98-210. We are not aware of any improper actions taken in connection with these subpoenas.

III. APPLICATION OF LEGAL STANDARDS

A. Evaluation of Potential Professional Liability Claims

KS's investigations into a change in the Trust Estate's domicile and tax status, as well as its intermediate sanctions lobbying efforts, raise serious questions regarding whether those investigations and efforts sufficiently furthered Trust Estate interests (as opposed to individual Trustee interests) to constitute a proper expenditure of Trust Estate funds. For those reasons, there is no question that they were properly cited by the Interim Trustees as grounds for removal of the Former Trustees. At the same time, the facts and circumstances do not support a conclusion that the legal services Verner Liipfert provided to KS in regard to these matters provide an adequate basis for establishing a breach of duty by Verner Liipfert. Nor do we find that Verner Liipfert had any disclosure obligations under Hawaii Probate Court Rule 42 or the Rules of Professional Conduct as to these matters. As discussed above in connection with each of these projects, Verner Liipfert was entitled to assume that the projects were a proper exercise of Trustee powers, and we found no evidence that Verner Liipfert had actual knowledge that these powers had been exceeded. We reach the same conclusions with respect to the work performed in connection with the two AG subpoenas.

The more difficult issue is whether Verner Liipfert breached a professional duty or obligation as a result of its submissions to the Master and to the court. In this context, we note that these submissions were made to provide facts and information to the Master and the court, not as "advocacy" submissions by counsel of record. We think that a potential claim exists here because of the two Temkin letters and the Temkin memorandum. (In this regard, we note that others at the Verner Liipfert firm participated to some extent in the preparation Temkin's letters and her memorandum; accordingly, other attorneys at this firm share (to varying degrees) responsibility for these documents.) For the reasons set forth below, however, we do not recommend that KS assert such a claim, either in the form of a professional liability claim or a claim for disgorgement.

To the extent that any such claim would be based on a violation of the Rules of Professional Conduct, those rules do not provide an independent basis for a cause of action. *See* Leubsdorf at 6. It could also be argued that there was no breach of duty to KS itself, that is, that Verner Liipfert was doing what it was asked to do. Indeed, it should be assumed that Verner Liipfert would argue that its submissions were drafted and filed with the full awareness of KS. For example, these submissions were drafted at the request of Nathan Aipa, and he was well aware of their contents. In addition, Trustee Wong submitted the October 15 Temkin memorandum to the Probate Court, and Trustees Lindsey and Peters filed pleadings with the Probate Court quoting extensively from the memorandum. Thus, it could be said that the Temkin submissions were endorsed by KS personnel who were aware of the lobbying effort.

It should also be noted that the burden of proving that a lawyer has knowingly made a false statement of material fact, or offered evidence that the lawyer knows to be false, could be quite difficult to carry. *See* HRPC 3.3(a); D.C. Rule 3.3(a). As noted in the discussion of these standards in Part IV if this Report, most of the cases enforcing these rules involve an attorney lying to a court or making representations wholly unsupported by the evidence. In the instant case, the contemporaneous documents tell one story and the Temkin submissions, supported by the interviews of the Dwyer, Temkin, Waihee, and Wong, tell another. It must be assumed that any claim against Verner Liipfert asserting a breach of the duty of candor to the tribunal would be hotly contested. Presumably, Verner Liipfert would argue that its view of the facts is the more complete of the two and is based on all of the internal and external discussions during the September 1995 through July 1996 lobbying time period, not just the contemporaneous documentation, which may not reflect the full picture. On this basis, Verner Liipfert would likely argue that its representations to the Master and to the Probate Court are supported by the evidence.

In considering whether to file a claim, the Trustees will also want to consider both the cost of prosecuting such an action as well as the length of time such a proceeding might take. The concern here is that a trial relating to the intermediate sanctions lobbying effort would likely cover much of the 1993-1998 time period and include a number of issues, such as Trustee compensation, the domicile and tax status project, the 1995-96 intermediate sanctions lobbying effort, and the "justification" efforts over the 1997-98 time period. In terms of potential recovery, KS would be looking at a maximum of $530,000, with the potential for that amount being reduced by $200,000 or more to account for time devoted to the review and indexing of files, a project that was necessary in order to produce relevant materials to the Master. Accordingly, KS would face a proceeding that could take a year or more and involve extensive costs, with a limited potential for recovery. The Trustees will also want to consider the impact on KS of negative publicity and controversy that would accompany prolonged litigation—precisely the type of controversy that KS has worked so hard over the last 18 months to put behind it. Taking all of the foregoing factors into account, including the potential legal and factual obstacles to any such claim for relief, we do not recommend that KS pursue such a claim. In reaching this conclusion, we by no means condone the actions of Verner Liipfert. Temkin's letters to the Master and her memorandum that was filed with the Probate Court demonstrate a lack of forthrightness and do not reflect the kind of care that KS was entitled to expect from its outside counsel in responding to requests from a court-appointed Master or in preparing documents that would ultimately be submitted to the court.

B. Disgorgement

The case law on disgorgement is not well settled, either in Hawaii or elsewhere. There is some authority for the proposition that a lawyer or law firm should not be compensated for work that was "inappropriate." *See* Leubsdorf at 13. For the reasons discussed above, we do not believe there is a basis for seeking disgorgement on the domicile/tax status project or the intermediate sanctions lobbying. With respect to the efforts to justify the lobbying effort, we believe that there is a potential claim for disgorgement based on the Temkin submissions. Nevertheless, based on the considerations outlined above, we do not recommend that KS pursue such a claim.

C. Future Retention

In view of Verner Liipfert's submissions to the Master and to the Probate Court, we believe that Verner Liipfert's past service to the Trust Estate makes them unworthy of being considered for future work.

SECTION SIX - PROVIDER-SPECIFIC ANALYSIS FOR PRICEWATERHOUSECOOPERS

I. INTRODUCTION

In connection with our review of the services that PWC provided to KS, we interviewed the following PWC personnel: Mark McConaghy, Mike Repass, Howard Schoenfeld, and Betsy Case. In addition to reviewing PWC's general KS files, as well as the relevant files at KS, we also reviewed the personal files of each of these individuals for documents relevant to the areas under consideration.

PWC has served as the Trust Estate's principal outside tax consultant since the early 1980's, when Trustee Takabuki approached McConaghy to assist KS in preparing a ruling request on the tax consequences of voluntary fee conversions. In general, KS looked to PWC throughout the Review Period to advise KS on the federal tax implications of various proposed transactions and investment-related matters and to assist KS in its dealings with the IRS. KS also looked to PWC to advise the Trust Estate on the federal tax law standards applicable to tax-exempt organizations in general and to the Trust Estate and its Trustees in particular. The Trustees, Nathan Aipa, and other KS Legal Group personnel requested tax-related advice from Mark McConaghy and others at PWC only on a transaction-by-transaction, or subject-matter-specific basis. There was not a general retainer or similar arrangement between KS and PWC. KS did not expect PWC to provide unsolicited or general advice on tax-related matters that were not specifically brought to PWC's attention by KS personnel or the Trustees. This fact was confirmed in our interviews with relevant KS personnel.

Of the subject matters considered during our review, we determined that tax-related advice PWC provided with respect to the following issues requires a discussion in this Report:

compensation, lobbying with respect to the proposed intermediate sanctions legislation, change in tax status, the importance of arm's length relationships, the federal tax law standards applicable to tax-exempt organizations, certain investments, and the IRS audit. PWC's work in these areas is discussed in some detail below. Although PWC provided advice with respect to other issues under consideration in our review, such advice was not of a magnitude to warrant a substantive discussion in this Report. Some of the third parties whom we interviewed also asked that we look at McConaghy's co-investment with the Trust Estate in Benson Forests and McKenzie Methane, and the propriety of the partnership distribution when KS acquired the Benson Forest investment from RHSCI. Consequently, we included these issues in our review.

We found nothing to indicate that PWC provided services for individual Trustees. Moreover, in several instances, PWC declined to assist KS and the Former Trustees in carrying out what McConaghy and others viewed to be questionable objectives. For example, PWC declined to assist the Trustees in finding ways to avoid the disclosure rules applicable to tax-exempt organizations. PWC also declined to be involved in bringing an action against the IRS in federal court.

II. ISSUES IMPLICATED BY WORK PROVIDED BY PWC

A. Compensation

As discussed in detail in Part III, *supra*, McConaghy briefed the Former Trustees on several occasions regarding the applicable standards for determining the reasonableness of their compensation for federal tax purposes. Following the enactment of the intermediate sanctions legislation, McConaghy briefed the Trustees on the impact of the new law. PWC personnel also provided KS Legal Group staff (including General Counsel) with several memoranda and letters informing them of procedures for complying with the intermediate sanctions provision and the proposed regulations thereunder. For example, in May of 1998, PWC prepared a draft fiduciary responsibility and intermediate sanctions checklist that was intended to provide a diagnostic tool to assist KS in assessing current compliance with federal law and fiduciary standards, including the intermediate sanctions provision. At no point in time did KS ask PWC to evaluate whether the Former Trustees were properly applying the foregoing standards or procedures in determining their compensation, nor did KS ask PWC to review the compensation studies that SCA and Towers Perrin prepared to evaluate whether the studies applied the appropriate criteria.

KS asked PWC to assist in preparing the Trust Estate's response to the IRS's 1994 request for technical advice on the compensation issue. In preparing the response, PWC was not asked to marshal the relevant facts; rather, KS staff prepared the first draft of the response and PWC helped to revise it for presentation to the IRS. In helping to draft the response to the request for technical advice, PWC relied on the 1993 SCA compensation study. PWC was not involved in selecting SCA; SCA's work was coordinated and supervised by KS staff. PWC did not question the methodology that SCA applied in reaching its conclusions. Both Repass and McConaghy stated in their interviews that if KS *had* asked PWC to evaluate the SCA study, or to perform an independent evaluation of Trustee compensation, each would have recommended that KS contact the PWC office at which PWC's compensation consultants were based. PWC was also not involved in the selection of Towers Perrin to perform a second compensation study in 1996, nor did PWC assist Towers Perrin in the preparation of its study.

Repass and McConaghy attended the meeting with Charles Barrett of the IRS on December 13, 1995 to discuss the IRS's request for technical advice and KS's response. At this meeting, Barrett expressed concern over the level of the Trustees' compensation. Barrett took the position that state law was not determinative of the reasonableness of Trustee compensation and criticized the KS report for not considering non-profit comparables, but he offered no definitive guidance on how compensation should be set.

Following the meeting, McConaghy advised the Former Trustees that Barrett took the position that the state statute setting maximum trustee commissions was not determinative of reasonableness for federal tax law purposes. McConaghy also informed the Trustees of Barrett's criticisms of the SCA study's reliance on exclusively for-profit comparables and the study's failure to evaluate the Trustees on an individual basis. KS did not ask PWC to assist the Trust Estate in addressing these concerns and criticisms. In July of 1996, however, just before the proposed intermediate sanctions provisions were enacted into law, PWC advised Trustee Wong that "regardless of whether or not KS can invoke a rebuttable presumption of reasonableness, the Trustees will most likely want to obtain a credible compensation study from a reputable firm." In our interview of McConaghy, he stated that he told the Former Trustees on several occasions that their compensation was going to be challenged by the IRS because the Service believed their compensation was too high and that they should be proactive in dealing with it. Despite this advice, the Trustees took no action to reduce the level of their compensation.

In September of 1998, Repass and McConaghy prepared a memorandum for the General Counsel listing possible approaches KS might consider taking to document the reasonableness of compensation for federal tax law purposes. An almost identical version of this memorandum was sent to Bruce Graham for use in his preparation of the Former Trustees' "Response for a Plan for Determining Trustee Compensation." PWC offered assistance to Graham in drafting this Plan insomuch as it implicated the application of the federal tax law standards for determining the reasonableness of compensation (including the requirements imposed by the intermediate sanctions provision and proposed regulations). McConaghy also advised Graham in February of 1999 on how the Trustees could continue to take monthly compensation draws before a determination of the exact level of compensation to which they were entitled was made under the Plan. McConaghy essentially advised that a procedure be adopted under which the Former Trustees would pay back any excess compensation to KS once the level of reasonable compensation was determined under the Plan.

B. Lobbying with Respect to Intermediate Sanctions

1. PWC's Role with Respect to KS's Lobbying Efforts

PWC was involved in the lobbying effort from the outset, when—as McConaghy acknowledged in our interview—the legislative strategy was to defeat the bill. PWC's role was to serve as a resource for Verner Liipfert on the more technical tax issues raised during the course of the lobbying effort. Although either Repass or McConaghy would attend meetings at Verner Liipfert to discuss the lobbying effort, PWC was not kept apprised of every step that Verner Liipfert made. Repass and McConaghy primarily assisted Susan Temkin and other Verner Liipfert attorneys in drafting suggested modifications to the proposed legislation (and the accompanying legislative history) as well as materials to provide to Congressional staffers and committee members. Verner Liipfert led the lobbying effort and made most of the lobbying contacts. Although McConaghy contacted certain Congressional staffers, PWC did not lobby members of Congress. The lobbying effort was coordinated by Verner Liipfert; PWC was not always made aware of Verner Liipfert's lobbying-related activities.

The strategy to defeat the bill emanated from Trustee Wong. PWC advised Trustee Wong and Verner Liipfert that this strategy was highly unlikely to succeed, because the proposed legislation was globally perceived to be good government and a benefit to the exempt organizations community. PWC did not participate in efforts to defeat the legislation. PWC advised the Trust Estate to focus instead on modifying the legislation to make it more palatable to the Trust Estate. From PWC's point of view, the focus of the proposed modifications was on: (1) modifying the standards that applied in determining reasonable compensation and eliminating the infamous state-law footnote; (2) eliminating the exit tax (which was removed from the proposed legislation in November of 1995); (3) obtaining criteria and guidance for determining reasonable compensation; and (4) modifying the disclosure requirements under the proposed legislation to protect the Trust Estate from requests for the Trust Estate's Forms 990 that were motivated by animus or an attempt to harass the Trust Estate or its Trustees. As discussed *supra* in our provider-specific analysis of Verner Liipfert, the modifications that PWC reviewed or assisted Verner Liipfert in drafting were aimed, *inter alia*, at deleting or modifying the infamous state law footnote (so as to cause a state or local legislative or administrative body's authorization or approval of a particular compensation package to be determinative of reasonableness) and at focusing the appropriate comparables for determining compensation on trustees and employees performing services for taxable as well as tax-exempt entities.

2. Advice on the "Tax Consequences" of the Lobbying

Section 501(h) of the Code permits charitable organizations that so elect to spend annually a certain percentage of their exempt purpose expenditures (not to exceed $1 million) on lobbying to influence legislation. These lobbying costs must be reported, however, on the organization's Form 990. Costs incurred for lobbying with respect to legislation that might affect the existence of the organization, its powers and duties, or that might affect the deduction of contributions to the organization, are not counted toward the organization's annual cap on lobbying expenses and need not be reported on the Form 990. This is the so-called "self-defense exception."

In October of 1995, Trustee Wong asked PWC whether the cost of lobbying against the intermediate sanctions legislation would need to be reported on the Trust Estate's Forms 990. McConaghy prepared a memorandum to Trustee Wong in response to this inquiry. The memorandum states that, because "they are made with respect to a possible decision of Congress which might affect the existence of the [organization], its powers and duties, or the deduction of contributions to such [organization]," amounts paid for such lobbying services "fall within the self-defense exception" to federal income tax prohibitions on "influencing legislation" provided under the Code. As such, this "self-defense" memorandum concludes that "no adverse tax consequences will arise in connection with these payments as long as the amounts expended were reasonable and that the payment or incurrence of such expenses is consistent with ordinary business care."

3. Post-Enactment Characterizations of the Trust Estate's Lobbying Efforts

After the intermediate sanctions legislation was enacted, PWC's involvement with respect to the intermediate sanctions issue was limited to briefing the Former Trustees on the requirements of the legislation, providing the KS Legal Group with information on compliance with the statute and proposed regulations, and contacting and discussing the regulations with the IRS and Treasury. PWC was also involved in reviewing documents that described the Trust Estate's lobbying efforts.

The first of these documents was a draft "Fact Sheet" on KS's intermediate sanctions lobbying efforts, dated September 9, 1997, which lists Howard Schoenfeld as the author. In our interview of Schoenfeld, he stated that he reviewed this document for technical accuracy, but the facts were provided by someone at KS. Notations on the document suggest that the document was in fact drafted somewhere other than PWC and sent to PWC for its review. The document lists "four major areas of concern" for KS regarding the proposed intermediate sanctions legislation: (1) the failure of the pending rules to address the structural differences between charitable trusts and charitable corporations, which would deny charitable trusts the benefits of certain safe harbor provisions applicable to corporations; (2) the potential for proposals for filing and disclosure to create the opportunity for harassment and diversion of resources due to unreasonable demands for documents already available to the public; (3) the requirement that public charities file their tax returns electronically in a form prescribed by the IRS; and (4) the potential that the overly broad definition of "disqualified person" would reach KS employee-managers who did not in fact direct KS activities and operations.

Although the document purports to describe the reasons underlying KS's lobbying efforts, nowhere does it describe the lobbyists' significant attention to those provisions that could have an impact on Trustee compensation. Moreover, it states that "KS was not lobbying to defeat this legislation," but rather was directing its efforts "at improving the legislation and making it more workable." In these two critical senses the document is erroneous and misleading. Although Schoenfeld reviewed the document, he was not with PWC at the time Verner Liipfert was conducting the intermediate sanctions lobbying. As a consequence, he was not in a position to evaluate the factual accuracy of the document. Schoenfeld agreed that based on what he knows now, the document was "misleading" in the sense that KS did initially try to defeat the legislation. He did not, however, believe it was significant that a discussion of the legislation's potential impact on Trustee compensation was omitted from the document's discussion of the "major areas" on which the lobbying was focused. Schoenfeld thought that the Trust Estate's public affairs division intended to use the document as a script for responding to media inquiries stemming from the AG's investigation.

In late 1997 and early 1998, McConaghy and Schoenfeld also reviewed various drafts of the Susan Temkin memoranda that formed the basis for her August and September 1998 letters to Master Matsumoto. These two letters, which purport to explain the Trust Estate's intermediate sanctions lobbying efforts, are discussed in detail in the provider-specific analysis of Verner Liipfert, *supra*. After reviewing earlier drafts of Temkin's memoranda, McConaghy and Schoenfeld communicated several reservations about the correctness of the memoranda and suggested several ways to revise the discussion to make it more accurate and complete. (*See* the discussion of these suggestions, *supra*, in the provider-specific analysis of Verner Liipfert.) Because Temkin did not take into account these suggestions in later drafts of her memoranda, McConaghy and Schoenfeld made it clear that they were limiting their comments on the later drafts to "technical" changes (that is, to comments on the memoranda's statements of the tax law rather than on the memoranda's factual statements regarding KS's lobbying efforts). PWC thought that Temkin's memoranda did not paint an accurate picture of the history of the legislation. Moreover, because PWC did not feel that Verner Liipfert had made PWC aware of all of the lobby efforts Verner Liipfert conducted, PWC declined to comment on the memorandum's description of the lobbying effort.

C. Change in Tax Status

Verner Liipfert had advised the Former Trustees that KS could convert to taxable status without incurring significant tax consequence. This idea appealed to some of the Trustees, but seemed illogical to KS General Counsel Nathan Aipa. As a consequence, he asked PWC to examine the issue. In the Spring of 1998, PWC drafted three memoranda on the topic of converting KS from a tax-exempt to a taxable entity. In general, the memoranda conclude that an organization may not voluntarily relinquish its tax-exempt status, but that it could take actions that violate the statutory requirements for exemption in the expectation that the IRS would revoke the organization's tax-exempt status. The memoranda, however, emphasized the advantages of tax-exempt status and pointed out the numerous disadvantages of a loss of that status. PWC also noted in the memoranda that relinquishing KS's tax-exempt status could constitute a breach of the Trustees' fiduciary duty, but that PWC was not qualified to opine on this issue. PWC recommended that the Trustees seek the advice of competent legal counsel on whether the potential for a change in the organization's tax status would constitute a breach of fiduciary duty. At no time did PWC work in conjunction with Verner Liipfert on this issue.

D. Arm's Length Relationships

As KS's investment activity became more complex in the late 1980's and early 1990's, KS established a number of taxable subsidiaries. KS Trustees sat on the Boards of these subsidiaries and KS staff performed work for the subsidiaries, which created arm's length issues for federal tax purposes. KS sought advice from PWC on these issues and on several occasions over the 1993-1995 time period, PWC advised KS regarding the importance of maintaining arm's length relationships between KS and its taxable subsidiaries.

In 1993, McConaghy provided KS General Counsel with materials to use in preparing a briefing for the Trustees on arm's length issues during their July 19, 1993 Turtle Bay retreat. McConaghy also briefed the Trustees on this issue later in 1993 and assisted Aipa in preparing a follow-up memorandum regarding important arm's length issues that the Trustees needed to address. The KS Legal Group prepared a Strategic Planning report in August of 1994, which included an opinion from McConaghy advising KS that neglecting proper arm's length relationships could result in a loss of KS's tax-exempt status. McConaghy's opinion emphasized that it was important for KS personnel to refrain from participating in the day-to-day operations of KS's taxable subsidiaries and recommended that KS adopt appropriate procedures to address these issues. Finally, in November of 1995, PWC sent KS a memorandum discussing the implementation of a cost-reimbursement program for services that KS provided to its subsidiaries. PWC's memorandum emphasizes that such a program would help maintain separate corporate identities between KS and its taxable subsidiaries, which would help preserve KS's tax-exempt status.

Thus, PWC's advice on the issue of arm's length relationships was limited to providing general advice on the issue and recommending certain procedures that would help to preserve KS's tax-exempt status. KS did not ask PWC to assist in implementing these procedures or in following up on whether proper procedures were put in place. PWC's advice in these instances was proper, correct, and in the best interest of the Trust Estate.

PWC also provided material to KS regarding the need for and proper structuring of an internal audit function and advised that the internal auditor could not report directly to the Trustees. Not only did the Trustees fail to heed this advice, they transferred the internal audit function to the Office of Budget and Review and ultimately abolished the position. PWC was not involved in any decisions whether to implement or abolish the internal audit function.

E. General Advice Regarding Federal Tax Law Standards Applicable to Tax-Exempt Organizations

PWC responded to a number of inquiries from the KS Legal Group and the Trustees regarding the requirements that federal tax law placed on KS. The advice PWC provided to KS on these issues was sound and genuinely benefited the Trust Estate. Moreover, we found that PWC was not reluctant to give the Trustees advice that was contrary to the advice the Trustees would like to have received. One example is the memoranda prepared in response to the inquiry regarding the possibility of converting KS to a taxable entity, discussed above. In preparing their verbal or written response to such inquiries, PWC advised the Trustees of the disadvantages of the proposed course of action and pointed out the restrictions that the law of tax-exempt organizations placed on the actions proposed by the Trustees.

Another example of a response to such an inquiry is a memorandum that PWC prepared on the ability of KS to reorganize as a church that operated as a school. The impetus for the inquiry appears to have been a desire to take advantage of an exemption from federal income tax reporting requirements that applies to churches. In a memorandum prepared for KS on this issue, PWC stressed that such a restructuring of KS was not likely to be respected for federal tax purposes, particularly if the restructuring was intended to relieve KS from any annual information return reporting or disclosure requirements that were less demanding than KS's current obligations under the federal tax law.

F. Advice Concerning the Tax Consequences of Investments

KS periodically called on PWC for investment-related tax advice; however, the Trustees did not ask PWC for on-going, comprehensive advice with respect to investments. For example, PWC advised the Legal Group on the tax consequences of: certain transfers of assets from KS to taxable subsidiaries (*e.g.*, Accessory Place and Tribeca); the restructuring of certain investments (*e.g.*, RTJ Acquisition); and taking of losses at the subsidiary rather than at the parent level (*e.g.*, Pembridge). PWC did not participate in making decisions to transfer investments. PWC provided advice on investment matters after the Trustees had already made a decision with respect to an investment.

PWC also performed due diligence on two Trust Estate investments: Goldman Sachs and SoCal. The due diligence that PWC performed with respect to Goldman Sachs was comprehensive, but KS asked PWC to perform only a limited tax due diligence on SoCal. The Trustees had already decided to make the investment in SoCal and wanted to spend only a limited amount of money to justify their decision. PWC challenged the valuation of the investment that the Trustees obtained, but the Trustees took no responsive action.

Other than the Goldman Sachs and SoCal investments, we found no evidence that PWC was involved in performing due diligence with respect to KS investments. In addition, other than the Benson Forests investment, discussed below, we found no instance in which PWC recommended investments to the Former Trustees. As a consequence, we found nothing to suggest that PWC bears any responsibility for the investment losses KS incurred during the Review Period.

We have not evaluated PWC's work with respect to the subsidiary reorganization that resulted in the transfer of all of the assets of Pauahi Holdings Corporation (including the limited partnership interest in Goldman Sachs Group L.P. previously held by RHSCI), to Kamehameha Activities Association. That reorganization, however, has been evaluated by a Special Master appointed by the Probate Court, Ben Matsubara, who concluded that the reorganization was undertaken for a valid business purpose and was in the best interests of the Trust Estate.[32]

G. McConaghy Co-Investments

Mark McConaghy invested alongside KS in two ventures: the HAK-III partnership investment in SG Methane and the Benson Forests investment.

1. SG Methane/HAK-III Investment

As described in more detail in Part III of this Report, KS through RHSCI acquired a net profits interest in SG Methane, a partnership that acquired a working interest in McKenzie Methane Company, which owned various coal seam gas leases. KS did not wish to acquire a working interest in the investment because income from a working interest would have given rise

32 *See* Special Master's Report re: Petition with Respect to KAA and the Ke Ali'i Pauahi Scholarship Fund, filed October 20, 1998.

to unrelated business taxable income. Trustee Takabuki called McConaghy to ask him whether he would be interested in investing in a partnership, known as HAK-III, that planned to invest in a working interest in SG Methane. Trustee Takabuki was the principal organizer of the HAK-III partnership and intended to offer "friends" of the Trust Estate and of Trustee Takabuki an opportunity to invest in the partnership.

McConaghy initially invested $12,500 in HAK-III along with other KS employees and "friends" of the Trust Estate (*e.g.*, Trustees Takabuki, Peters, Thompson, and Richardson, Gilbert Ishikawa, Rodney Park, Wallace Chin, and Frederick Field). McConaghy invested another $12,500 in response to a capital call, making his total investment in HAK-III $25,000. Prior to making the investment, McConaghy consulted with PWC's Senior Tax Partner and was advised that investing in the project was permissible inasmuch as neither KS nor the HAK group was an audit client of PWC. As discussed in more detail in Part III of this Report, the methane gas venture went through bankruptcy—twice—and KS sustained a significant loss on its investment. McConaghy's investment in HAK-III was a complete loss. McConaghy did not participate in the subsequent litigation involving the investment, nor was he asked to do so. McConaghy did not provide any tax advice with respect to the investment. Karl Moody, from PWC's Houston office, provided tax advice to KS related to the investment and prepared the returns for the KS subsidiary, KUKUI, Inc., to which the investment was transferred in 1992. Moody was not selected because of any perceived conflict of interest involving McConaghy but because Moody had oil and gas auditing experience. McConaghy stated that he doubted Moody or anyone in PWC's Houston office knew about McConaghy's co-investment.

2. Benson Forests Limited Partnership

Ben Benson, a friend of McConaghy, had an investment proposal to purchase real estate lots on the Eastern Shore of Virginia in tax sales and then sell the lots in a revived real estate market. McConaghy thought that the investment would be good for KS, especially in light of recent investments with other partners that had not produced good returns for the Trust Estate; thus, McConaghy introduced Ben Benson to Trustee Takabuki. Trustee Takabuki told McConaghy that he was interested in having KS invest with Benson. Because Trustee Takabuki did not know Benson, he asked McConaghy to invest some of his own money in the venture to demonstrate that McConaghy thought the investment was a sound one. McConaghy agreed, and the investment was made in the form of a limited partnership.

The partnership bought up the real estate lots as originally planned and subsequently sold many of them for a significant profit (for example, lots that were purchased for $500 were sold for $15,000). In late 1990, Benson became aware of approximately 300,000 acres of timberland for sale in Michigan. Benson worked out a deal to purchase the timberland using the value present in the remaining real estate lots; the original investment was rolled into an investment in the timberland, now known as Benson Forests Limited Partnership ("BF Partnership").

It has been alleged that McConaghy received more favorable treatment than the Trust Estate after KS purchased the assets of the BF Partnership for $60 million on October 11, 1994. It was asserted that McConaghy's tax gain of $1,724,062 for his 3.38% interest was out of proportion with the $187,482 tax gain that RHSCI reported for its 98% interest in the partnership. It was further alleged that, if the gain had been allocated according to the partner's cash contributions, RHSCI would have had $14.7 million in gain, compared to a gain of $29,858

Essentially, the adjustments reach the same result that would have been reached if the partners had first sold their interests to a third party just prior to RHSCI's additional $45 million capital contribution, and then reinvested in a new partnership: (1) each partner's initial capital contribution; and (2) each partner's share of the gain attributable to the appreciation of the BF Partnership assets as of the date of sale. Had the adjustments been made based solely on each partner's relative total capital contributions after RHSCI's additional $45 million investment, the partners (except for RHSCI) would have been divested of the partner's equitable share of the appreciation of the partnership assets prior to RHSCI's additional contribution of capital.

The percentage of each partners' relative total capital contribution after RHSCI's additional capital contribution was as follows:

Forest Management	.01%
Ben Benson	.88%
Mark McConaghy	.22%
RHSCI	98.89%.

BF NOPA at 14. For the reasons just discussed, however, these are not the appropriate percentages to use in determining each partner's share of the proceeds of a subsequent sale of the partnership's assets. Rather, the correct percentages are the adjusted capital account percentages stated above, which account for the fact that the underlying assets in the partnership had appreciated substantially before RHSCI made an additional investment of capital in the amount of $45 million. Thus, of the $60 million that KS paid for the partnership's assets on October 11, 1994, each partner was entitled to the following percentage and amount:

Forest Management	8.12%	or	$ 4.872 million
Ben Benson	13.50%	or	$ 8.100 million

Mark McConaghy	3.38%	or	\$ 2.028 million
RHSCI	75.00%	or	\$ 45.000 million.

According to the IRS, each partner in fact received the following final cash distributions from the BF partnership before it dissolved after the sale:

Forest Management	\$ 5,028,355
Ben Benson	\$ 8,311,394
Mark McConaghy	\$ 2,080,898
RHSCI	\$46,261,944.

BF NOPA at 18. (The amounts that each partner received upon dissolution of the partnership were slightly higher than each partner's percentage share of the \$60 million sales proceeds because the partnership had income from other sources that needed to be distributed before the partnership could be wound up.)

The critical fact for a correct analysis of the situation is not how much each partner contributed, but when each partner made its contribution—before or after the partnership assets had already appreciated substantially. At the time the allocation was made, just prior to RHSCI's additional capital contribution, the partners agreed that the partnership assets had a value of approximately \$64 million. *Id.* at 12. Thus, the bulk of the appreciation in the partnership's assets occurred before RHSCI's \$45 million additional capital contribution and was fairly attributable to the capital contributions each partner made prior to December 10, 1993.

A year later, the BP Partnership was liquidated and its assets were sold to KS for \$60 million. When Trustee Takabuki retired from KS, Benson dealt with Trustee Peters on matters related to the Benson Forest investment. Benson became frustrated with Trustee Peter's inability to make timely decisions (*e.g.*, a decision whether or not to grant an easement took three months to make). Subsequent health problems, combined with these issues, led Benson to seek a buyer for the investment. Trustee Peters refused to sell the investment to a third party, however, despite offers of approximately $80 million and an appraisal that valued the land at approximately $90 million. Subsequently, KS offered to buy out the investment for $60 million. Owing to his desire to terminate his dealings with the Trust Estate, Benson agreed.

McConaghy recused himself from any dealings with Trustee Peters or KS regarding the sale of the investment and told Benson that he needed to ensure that the deal was done at arm's length. Although McConaghy realized a substantial return on his investment in BF Partnership (as discussed above), his return was significantly less than the return he would have received if the property had been sold earlier for $80 million. KS still owns the investment, which has continued to appreciate since KS bought out McConaghy and Benson. Appreciation after the partnership's dissolution has resulted in an estimated value attributable to the former BF Partnership assets of approximately $170 million.

Finally, as shown by the decision of the IRS to withdraw its proposed reallocation of gain to RHSCI, the allocations among the parties did fairly reflect the economic contributions of the partners. Under federal tax law, partners agree to allocations of gain and loss in the partnership agreement; for these allocations to have effect for federal tax purposes, they must be consistent with the underlying economic arrangement of the partners, which is reflected in the partners' capital accounts. How much gain or loss a partner recognizes is determined by how much the proceeds received in liquidation exceed (or are less than) the partners' capital accounts. The tax law permits partners to restate their capital accounts when another partner makes a capital contribution to allocate the gain among the existing partners. This allocates to the existing partners their "fair share" of the appreciation, before being diluted by the contributing partner.

The partners allocate the appreciation earned after that date based on their new relative capital contribution. These accounts are increased if the partner contributes cash or is allocated gain, and decreased if the partner receives cash or deducts expenses.

The gain that McConaghy reported for federal tax purposes properly reflected the partnership allocation of his share of the gain in the property at the time RHSCI "purchased" its additional partnership interests through the $45 million capital contribution. Similarly, the $187,482 tax gain that RHSCI reported was also a function of the partnership allocation to which the partners agreed; it was not, nor should it have been, based on RHSCI's total capital contribution as of the date the partnership assets were sold. If the gain had been allocated according to the partners' total cash contributions as of the date of sale (*e.g.*, 99% to RHSCI and .22% to McConaghy) this would not have followed the true economic benefits of the transaction, since substantial appreciation in the underlying assets occurred prior to RHSCI's $45 million capital contribution.

Moreover, the allegation that if the gain had been allocated according to the partner's cash contributions RHSCI would have had a much higher gain ($14.7 million compared to $187,482) appears to miss the point that, for tax purposes, it is in RHSCI's best interest to have as little gain allocated to it as possible. Indeed, if, as the allegation suggests, McConaghy was allocated more of the gain on the transaction than he should have been (which is not the case), this would be to McConaghy's detriment and RHSCI's benefit. McConaghy would essentially be paying part of RHSCI's tax bill by realizing some of the tax gain on which RHSCI should have paid the corresponding tax.

3. McConaghy's Actions to Evaluate the Propriety of the Co-investments and Disclosures of his Co-investments to KS

As discussed above, McConaghy consulted with PWC's Senior Tax Partner to determine whether there was any bar to his investing in HAK-III. McConaghy was told that because neither the Trust Estate, SG Methane, nor HAK-III was an audit client of PWC (then PWC), there was no bar to his investing in the HAK-III partnership. McConaghy also stated in his interview that he was told that an opinion had been prepared by Hawaii counsel for the Trust Estate concluding that there was no legal or ethical bar to KS employees investing in HAK-III. McConaghy was not shown the opinion and did not ask to see it. Nor did McConaghy discuss the propriety of the co-investment with PWC's legal counsel. At the time he made the investment in what eventually became the BF Partnership, McConaghy did not discuss the propriety of his co-investment with PWC legal counsel. As with the HAK-III investment, McConaghy assumed that the only relevant bar to co-investing was co-investing with an audit client.

McConaghy disclosed his co-investments in both the HAK-III partnership and the BF Partnership to the Interim Trustees when they were appointed as Special Purpose Trustees for purposes of resolving the issues raised by the IRS audit. McConaghy also disclosed his co-investments to Master Matsumoto.

H. PWC's Role with Respect to the IRS Audit

PWC substantially assisted KS in responding to the IRS's audit inquiries and in responding to the tax issues raised during the audit. For example, Howard Schoenfeld worked with KS staff to ensure that they prepared proper responses to the many IDRs that the IRS served on the Trust Estate. Notably, McConaghy advised Trustee Peters that refusing to respond to the IDRs was not in the Trust Estate's best interest. McConaghy and others from PWC provided on-going audit strategy advice and worked to formulate written responses to the IRS arguments presented in its draft Forms 5701. As the current Trustees are aware, McConaghy and others from PWC also were instrumental in negotiating the closing agreement with the IRS that preserved the Trust Estate's tax-exempt status on a retroactive and prospective basis and also minimized the tax liability of the Trust Estate and its subsidiaries with respect to the technical tax issues raised on audit.

McConaghy also assisted Master Matsumoto and General Counsel Nathan Aipa in formulating a mechanism to respond to the conflicts of interest between the Former Trustees' personal interests and those of the Trust Estate that were raised by the draft Forms 5701. While serving on the conflicts panel appointed by the Probate Court (discussed *supra*, in Part III of this Report), McConaghy determined that there were actual and apparent conflicts of interest; along with Master Matsumoto and Nathan Aipa, McConaghy reported this determination to the Probate Court. This led to the appointment of the Special Purpose Trustees and, ultimately, the resignation of the Former Trustees.

III. ANALYSIS OF POTENTIAL CLAIMS BASED ON WORK PROVIDED BY PWC

A. Legal and Professional Standards Applied in Evaluating the Work Provided by PWC

In analyzing whether any claims arise out of the work performed by PWC, we have analyzed standards applicable to both accountants (specifically, tax practitioners) and lawyers. As a matter of law, it is an unsettled issue as to which set of standards applies to PWC personnel, because the members of PWC who provided advice to the Trust Estate during the Review Period, such as Mark McConaghy, are lawyers working for an accounting firm. *See* Leubsdorf at 16. To his credit, during our interview with McConaghy, he stated that he assumed that he was bound by both sets of standards. Accordingly, we chose to analyze whether actions by PWC personnel during the Review Period violated either the law governing lawyers, or the standards of practice governing tax practitioners, as promulgated by the AICPA and the United States Treasury Department. In our view, a court would consider all of these sources when determining the applicable standard of care for services provided by a tax practitioner working for an accounting firm.

The standards of professional conduct applicable to lawyers have already been described *supra*, in Part IV of this Report. We have looked to three sources for standards of professional conduct applicable to tax practitioners: regulations issued by the United States Department of the Treasury and based on *Circular 230, Rules for Practice Before the Internal Revenue Service* (the "Treasury regulations"), the AICPA's Code of Professional Conduct and interpretations thereof (the "AICPA Code"), and the AICPA's Statements of Responsibility in Tax Practice (the "AICPA Statements"). The Treasury regulations apply equally to attorneys and nonattorneys permitted to practice before the IRS. 31 C.F.R. §§ 10.3-4 (2000). (Indeed, the regulations suggest that it is not material whether the tax practitioner held himself or herself out to be an attorney practicing tax law or as a CPA giving tax advice.) The AICPA Code provides ethical standards of conduct applicable to accounting professionals; the AICPA Statements are a collection of statements that are intended to represent a body of advisory opinions on appropriate standards of federal income tax practice. AICPA Statements on Responsibilities in Tax Practice §§ 102.02, .04 & .08 (1988). The AICPA Statements are "educational and advisory" and purport to "take into account applicable legal requirements of tax practice as well as the [AICPA] Tax Division's opinions as to appropriate standards of responsibility in tax practice." *Id.* § 102.02 (as modified in 1991).

1. General Standards of Conduct for Tax Practitioners

The AICPA Code requires members to exercise "due professional care in the performance of professional services." AICPA Code of Prof'l Conduct § 201(B) (1988). The AICPA Statements require tax practitioners to ensure that tax advice they provide "reflects professional competence and appropriately serves the client's needs." AICPA Statements on Responsibilities in Tax Practice § 182.02. A member of the AICPA is permitted to undertake "only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence." AICPA Code of Prof'l Conduct § 201(A). Under the AICPA Code, "[a] member's agreement to perform professional services implies that the member has the necessary competence to complete those professional services according to professional standards, applying his or her knowledge and skill with reasonable care and diligence." *Interpretation* 201-1 under Rule 201 of the AICPA Code of Professional Conduct.

> Competence to perform professional services involves both the technical qualifications of the member and the member's staff and the ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques, and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge in the performance of professional services.

Id.

The AICPA Code states that "[i]n the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others." AICPA Code of Prof'l Conduct § 102 (1988). With respect to conflicts of interest in particular, under the AICPA Code:

> A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate

> parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service.

Interpretation 102-2 under Rule 102 of the AICPA Code of Professional Conduct. The Treasury regulations also prohibit a tax practitioner from representing "conflicting interests . . . except by express consent of all directly interested parties after full disclosure has been made." 31 C.F.R. § 10.29 (2000).

Rule 102 of the AICPA Code applies to client requests "[t]o perform tax or consulting services engagements that involve acting as an advocate for the client." *Interpretation* 102-6 under Rule 102 of the AICPA Code of Prof'l Conduct. An accounting firm should consider whether it is appropriate to perform professional services for a client involving advocacy if there is a possibility that the requested services "may . . . stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk to . . . independence, integrity, and objectivity." *Id.*

Accountants, like lawyers, are also liable for negligent conduct in the course of representing clients—that is, for failing to use the necessary degree of diligence or care in providing tax advice. *See* Leubsdorf at 15-16. Thus, in general terms, accountants must comport themselves with "the skill and knowledge normally possessed by members of th[e] profession or trade in good standing." Restatement, Second, Torts §299A.

2. Standards Governing Tax Advice in Particular

Under the Treasury regulations and the AICPA Statements, a "realistic probability" standard governs tax advice, which prevents a tax practitioner from advocating a position that "does not have a realistic possibility of being sustained on the merits," unless the position is "not frivolous" and the practitioner advises the client to disclose the position. 31 C.F.R. § 10.34; AICPA Statements on Responsibilities in Tax Practice § 112.02(a) & (c) (1988). According to the Treasury's regulations, a position satisfies the "realistic possibility" requirement "if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one-in-three, or greater, likelihood of being sustained on the merits." 31 C.F.R. § 10.34(a)(4)(i). A position is "frivolous" if it is "patently improper." *Id.* § 10.34(a)(4)(ii); AICPA Statements on Responsibilities in Tax Practice § 112.09. A tax practitioner should not advise a client to take a certain position unless the tax practitioner believes "in good faith that the position is warranted in existing law or can be supported by a good faith argument for an extension, modification, or reversal of existing law." AICPA Statements on Responsibilities in Tax Practice § 112.07.

3. Continuing Duty to Provide Advice

In general, a tax practitioner is not expected to have assumed responsibility for communicating to the client when subsequent developments in the applicable tax law affect advice previously provided. AICPA Statements on Responsibilities in Tax Practice §§ 182.01 & .04 (1988). Moreover, at times a tax practitioner "is requested to provide tax advice but does not assist in implementing" the plans or procedures associated with this advice. *Id.* § 182.09. Accordingly, the duty to update advice previously given continues only so long as the tax practitioner is actively participating in implementing the procedures or plans associated with the advice, unless the tax practitioner undertakes this obligation by specific agreement with a client. *Id.* The communication of significant developments affecting previous advice is considered to be an additional service rather than an implied obligation in the typical client relationship. *Id.*

B. No Basis for a Professional Liability Claim Against PWC

We found no basis to assert a professional liability claim against PWC. As discussed in Part IV of this Report, a key element that KS would have to establish in asserting a professional liability claim is a breach of duty. We found no evidence that PWC violated any applicable standard of care by failing to exercise the degree of care, skill, diligence, and knowledge commonly possessed and exercised by a reasonable, careful, and prudent tax practitioner working for an accounting firm and engaged in providing tax advice. As we have already noted, in reaching this conclusion we have examined whether PWC violated either the standards of professional conduct applicable to lawyers or the standards of professional conduct applicable to non-attorney tax practitioners.

Nor does the record indicate that PWC had any disclosure obligations under the Hawaii Probate Court Rules or the Rules of Professional Conduct. PWC was not aware of any conduct by KS Trustees or employees that was known to be illegal. Nor was PWC aware of any criminal or fraudulent conduct, in furtherance of which PWC's services had been used, that resulted in substantial injury to the financial interests or property of another. Moreover, PWC did not assist the Trustees or KS employees in engaging in, or counsel them to engage in, conduct that PWC knew to be criminal or fraudulent.

The record reflects that PWC provided straightforward and honest advice on tax-related matters and was not deterred from giving candid advice by the prospect that the advice would be unpalatable to the client. As discussed above, in at least two instances PWC declined to provide advice on matters that might compromise PWC's credibility and thereby pose a risk to its independence, integrity, and objectivity. It is our assessment that PWC provided effective tax advice in response to subject-matter- or transaction-specific requests from KS Trustees or employees, or in response to requests for general advice on standards applicable to tax-exempt organizations. In providing tax advice, PWC did not advocate frivolous positions or positions that did not have a realistic possibility of being sustained on the merits.

We found that KS did not ask or expect PWC to assist in implementing procedures or plans associated with the advice PWC rendered (*e.g.*, in connection with arm's length dealings) or to provide continuing updates on advice previously given. For example, PWC was asked to brief the Former Trustees and General Counsel on the requirements that the intermediate sanctions law imposed on trustees of charitable organizations. Mark McConaghy briefed the Former Trustees on two separate occasions regarding the relevant standards. PWC also prepared several memoranda discussing procedures for complying with the legislation and the proposed regulations. The Former Trustees, however, made no changes in their compensation practices in response, and they never asked PWC to evaluate whether the IRS or a court would consider their compensation to be reasonable for federal tax law purposes. Furthermore, PWC was not asked to evaluate the compensation studies commissioned by the Trustees.

Moreover, even if PWC personnel personally believed that the absolute level of Trustee compensation was excessive, the PWC personnel who provided services to the Trust Estate were not competent to perform the valuations necessary to make a reasonableness determination. McConaghy and others did not possess the requisite technical qualifications or ability to supervise and evaluate the quality of work performed by KS' compensation consultants; nor were they competent to make the kinds of valuations necessary for determining what constitutes reasonable compensation. PWC was not asked to evaluate the compensation studies commissioned by the Trustees. Moreover, because SCA and Towers Perrin were nationally recognized compensation consulting firms, it was not unreasonable for PWC to assume that these firms were competent to perform a reliable study of Trustee compensation. Thus, PWC breached no legal or professional duties by failing to advise the Trustees that their compensation was excessive or that their compensation studies were deficient.

Similarly, PWC's advice with respect to a possible change in KS's tax status, KS's lobbying efforts, and inquiries such as whether KS could be restructured as a church entity, did not give rise to any breaches of PWC's legal or professional duties. In each of these cases, PWC was entitled to assume without inquiry the existence of the requisite trust power to request the advice and the Trustees' proper exercise of that power. Even if PWC foresaw or suspected at the outset that the course of action being considered would turn out to be unwarranted, PWC was nevertheless entitled to assume that the Trustees were entitled to an explanation of why and in what ways it was unwarranted. None of the courses of action with respect to which PWC provided advice was obviously illegal, completely adverse to the Trust Estate's interest, or devoid of any legitimate justification. We found no evidence that PWC spent an inordinate amount of time investigating such issues or ran up excessive fees in the process. Moreover, in each of these cases, PWC candidly advised KS when it thought the action considered would be inappropriate or raised concerns as to legality.

We identified only one area in which a question could be raised whether PWC gave proper tax advice to the former Trustees—PWC's 1995 opinion that the Trust Estate's lobbying expenditures in connection with the intermediate sanction lobbying effort fell within the "self-defense" exception to the federal tax law's definition of "influencing legislation." Although this self-defense memorandum concludes that there would be no adverse "tax consequences" as a consequence of intermediate sanctions lobbying, the memorandum does not discuss whether the cost of the lobbying effort could constitute inurement, which is the position the IRS later took in its draft Forms 5701. PWC informed us that it understood Trustee Wong's request to relate only to the treatment of these lobbying costs for purposes of reporting the costs on the Trust Estate's Forms 990. This understanding is reflected in the memorandum, which is limited to this point, and is supported by individuals on KS's staff familiar with the request. In our view, this was a reasonable understanding of Trustee Wong's request. Based on PWC's understanding, the advice contained in the memorandum was correct.

We discovered only one instance in which PWC was involved in conduct that raised a question as to whether PWC misrepresented facts or subordinated its judgment to others—PWC's participation in preparing the erroneous and misleading 1997 "fact sheet" on KS's intermediate sanctions lobbying efforts. The individual at PWC who was assigned the task of reviewing the draft, however, was not involved in the lobbying effort and was not aware that KS's initial lobbying strategy was to defeat the bill; nor did he prepare the first draft of the "fact sheet." Moreover, it is not clear that the "fact sheet" was in fact used so as to mislead any third parties or that KS suffered any damages on account of the misrepresentation. Accordingly, we do not believe that PWC's participation in drafting this "fact sheet" constitutes a breach of any duty to refrain from knowingly making false statements of material fact to a third person. We question, however, PWC's allowing one of its professionals to be in the position of commenting—without accurate facts—on an issue of such importance.

Finally, we do not believe that Mark McConaghy's co-investments with the Trust Estate gave rise to any breaches of duty. PWC's general representation of KS does not appear to have been limited in any way by McConaghy's interests in either the SG Methane or Benson Forests investments. The relationship was disclosed to the client—through Trustee Takabuki, who asked McConaghy to invest in both instances—and McConaghy and PWC recused themselves with respect to any negotiations with KS regarding the Benson Forests. McConaghy also disclosed these co-investments to the Master and to the Special Purpose Trustees when they were appointed by the Probate Court in February 1999. Accordingly, we do not believe that McConaghy or PWC had a conflict of interest with respect to these investments.

C. No Basis for a Claim for Disgorgement of Fees Paid to PWC

We also conclude that no claim for disgorgement exists with respect to the services that PWC provided to KS during the Review Period. PWC did not engage in any violation of the standard of care applicable to tax practitioners, an ethical obligation, or its duties to its client. Nor do the fees that PWC charged for the work provided appear to be excessive or unreasonable. Moreover, no evidence was found that PWC did work for individual Trustees or that PWC represented both the Trust Estate and individual Trustees under circumstances in which their interests diverged.

D. No Reason Exists to Discontinue PWC's Services

As noted, the record reflects that PWC's advice was sound and in the best interest of the Trust Estate. Moreover, to its credit the evidence demonstrates that PWC was not reluctant to give candid advice to the Trustees, even when it was not the advice the Trustees wanted to hear. As a consequence, we found no evidence that would preclude the Trustees from continuing to use PWC's Services should they choose to do so.